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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, [redacted] 1970

No. [redacted] 270

ILO VANDERBOOM, DeHAAN LIVESTOCK & GRAIN FARMS, INC., ANDY D. DeHAAN, KENNETH J. DeHAAN, LYLE R. DeHAAN, H. T. RINGLING, JAMES NACHTIGAL, ROBERT CARTER, R. S. MISKIMINS, RICHARD ADAMSON, WENDELL FOXLEY, JAMES KLAUDT, DONALD O. NACHTIGAL, WILLIAM NASH, ERVIN R. ORTMAN, HERBERT W. ORTMAN, STANLEY W. WEILAND, and INVESTORS THRIFT CORPORATION, an Arkansas Corporation,

Petitioners,

vs.

SAM SEXTON, JR., JAMES S. HALL, AUSTIN GATLIN, DIAMOND G RANCH, INC., an Arkansas Corporation, TEXAS CAPITAL CORPORATION, a Texas Small Business Investment Company,

Respondents.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit

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Respondents.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit

Ilo Vanderboom, DeHaan Livestock & Grain Farms, Inc., Andy D. DeHaan, Kenneth J. DeHaan, Lyle R. De Haan, H. T. Ringling, James Nachtigal, Robert Carter, R. S. Miskimins, Richard Adamson, Wendell Foxley, James Klaudt, Donald O. Nachtigal, William Nash, Ervin R. Ortman, Herbert W. Ortman, Stanley W. Weiland, and Investors Thrift Corporation, an Arkansas corporation, your petitioners, respectfully pray that a writ of certi-

orari be issued to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered in the above entitled cause on February 24, 1970.

REPORTS OF OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit by panel, was filed February 24, 1970, and is reported in 422 F. 2d 1233. The opinion is reproduced as Appendix "A" hereto. The judgment of the Court of Appeals dated February 24, 1970, is reproduced as Appendix "B" hereto. The companion case of Vanderboom v. The City National Bank of Fort Smith, Arkansas, is reported in 422 F. 2d 221.

The opinion on motion for summary judgment of the United States District Court for the Western District of Arkansas, Fort Smith Division, was filed on January 24, 1969, and is reported in 294 F. Supp. 1178. The opinion is reproduced as Appendix "C" hereto. The judgment of the District Court was entered on January 24, 1969, and is reproduced as Appendix "D" hereto.

GROUNDS ON WHICH JURISDICTION IS INVOKED

(i) The judgment of the United States Court of Appeals was dated and entered on February 24, 1970. See Appendix "B".

(ii) A timely petition for re-hearing was denied March 20, 1970. See Appendix "E". This petition for a writ of certiorari was filed within ninety (90) days of that date.

(iii) 28 U. S. C., Section 1254(1), confers on this Court jurisdiction to review the judgment of the United States Court of Appeals by writ of certiorari.

QUESTIONS PRESENTED FOR REVIEW

1. Class protected and class obligated—privity requirement: Does a securities purchaser, who purchases in reliance upon material misrepresentations and nondisclosures of third party insiders to the transaction, have a Rule 10 b-5 action against the third parties?

2. Conflicting Application of Limitations of Actions provisions: Should defrauded securities investors in interstate commerce be prevented from maintaining a Rule 10 b-5 action because of uncertainty created by conflicting decisions of United States Courts of Appeals as to the applicable statute of limitations?

STATUTES AND REGULATIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934 (48 Stat. 891 (1934), 15 U. S. C., Section 78j (b) (1964)):

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> * * * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

SEC Rule 10 b-5 (C. F. R., Section 240.10b-5 (1969)):

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality

of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Arkansas Statutes, Section 37-206, which reads in pertinent part as follows:

"The following actions shall be commenced within three (3) years . . . after the cause of action shall accrue: First, all actions (of debt) founded upon any contract, obligation, or liability (not under seal and not in writing), . . . fourth, all actions (of account, assumpsit, or on the case), founded on any contract or liability, expressed or implied; . . ."

Arkansas Statutes, Section 37-213 (1962 Repl.), provides as follows:

"All actions not included in the foregoing provisions shall be commenced within five (5) years after the cause of action shall have accrued."

Michigan Statutes Annotated, Section 19.756, Comp. Laws 1948, Section 451.116 (Repealed 1965), reads in pertinent part as follows:

"Any person who sells a security, which comes under the provisions of this act, by means of a prospectus

or other type of circular or advertising, or by oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statement, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission) and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, such untruth or omission, shall be liable to the person purchasing such security from him, and may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, upon the tender of such security, or for damages if he no longer owns the security.

No action shall be maintained to enforce any liability created under this section unless brought within two (2) years after the discovery of the untrue statement or omission or after such discovery should have been made by the exercise of reasonable diligence: provided, that in no event shall any such action be brought more than three (3) years after the sale. * * *"

Arkansas Statutes, Section 67-1256, from the Arkansas Securities Act, reads in pertinent part as follows:

"(a) Any person who . . .

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made in the light of circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have

known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent (6%) per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security and any income received on it, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six per cent (6%) per year from the date of disposition.

(b) Every person who controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aid in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable. * * *

(e) No person may sue under this section more than two (2) years after the contract of sale. * * *

(h) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or Section 4 (e) (Section 67-1238 (e)).''

Arkansas Statutes, Section 67-1235 (Section 1 of Act No. 254, Acts of the General Assembly of the State of Arkansas, 1959—Securities Act) reads as follows:

> "It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
>
> (1) To employ any device, scheme or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

STATEMENT OF THE CASE

This case is related to the case for which a petition for writ of certiorari to the United States Court of Appeals for the Eighth Circuit has already been filed in this Court, October term, 1969, No. 1483, styled Vanderboom, et al., petitioners against The City National Bank of Fort Smith, Arkansas, a national banking association, respondent. Both cases involve the same scheme to defraud, and the same securities transaction.

In the fall of 1965 and in the early part of 1966, the individual petitioners, and DeHaan Livestock & Grain Farms, Inc., citizens of the small farming community of Platte, South Dakota, purchased Class B, non-voting stock directly from a new Arkansas corporation, Investors Thrift Corporation, of Fort Smith, Arkansas (hereinafter called ITC), through the use of instrumentalities of in-

terstate commerce. The total purchase price for the non-voting stock was $747,300.00.

Other investors, through ITC, invested the additional sum of $200,000.00 for the total stock issue by ITC of $947,300.00. Originally, $150,000.00 was raised as the initial capital of ITC. The cause of action against the respondents in connection with that $150,000.00 belongs exclusively to the corporation, ITC.

The South Dakota investors purchased the additional amount of $597,300.00 of ITC stock in actual reliance upon the representations and conduct of Sam Sexton, Jr., James S. Hall, Huey Smith, Austin Gatlin, Diamond G Ranch, Inc., a Gatlin corporation, and Texas Capital corporation (now Telcom Corporation) a small business investment company of Georgetown, Texas. The representations were made both orally and in writing to the effect that certain assets owned by Hall, Sexton and Smith, formerly owned by Gatlin, and encumbered to Texas Capital Corporation, were very valuable businesses, highly profitable and sound, with a net worth in excess of a million dollars. Instrumentalities of interstate commerce were employed in connection with the actions of the respondents who defrauded the petitioners.

The representations were false, and the ITC stock was virtually worthless when the purchases were consummated by the investors. Likewise, the purchase by Investors Thrift Corporation of the business enterprises was consummated as a result of the fraudulent representations and scheme of the respondents, and the assets acquired as a result of this fraudulent scheme were worthless. The record before the Court reflects that the liabilities of the businesses actually acquired by ITC exceeded assets by one-half million dollars.

In late 1967, after completion of an audit of the business enterprises (acquired by ITC with its capital raised

from the South Dakota investors) disclosed the truth, the petitioners instituted a law suit for relief from the fraud perpetrated on them in the state court of South Dakota against The City National Bank of Fort Smith, James S. Hall, Sam Sexton, Huey Smith and Austin. However, the Bank obtained an injunction in the United States District Court for the Western District of Arkansas, based on federal venue statutes pertaining to national banks, against the maintenance of the South Dakota action against the Bank.

The Bank then instituted five (5) consolidated civil actions in the United States District Court (Fort Smith Division) against certain of these petitioners on the unpaid balance of promissory notes executed by the same petitioners to obtain a substantial portion of the funds used to purchase their ITC stock. The defendants in those actions, including petitioners here, counterclaimed alleging both SEC Rule 10 b-5 securities fraud and common law fraud. They then sought to join as parties defendant, the respondents in the case at bar, but the motion was denied. All of the petitioners here then filed a separate civil action in the United States District Court for the Western District of Arkansas, against the respondents, alleging a Rule 10 b-5 action and a common law fraud action. It is the latter separate civil action which is the subject of this petition for writ of certiorari.

No trial on the merits of the claim of the petitioners has ever been had in any action.

The basis for federal jurisdiction is Section 27 of the Securities Exchange Act of 1934, 15 U. S. C., 78 aa.

On December 5, 1968, the District Court below, sua sponte, dismissed so much of the complaint of the petitioners as alleged a common law fraud action for lack of diversity of citizenship because of the presence of ITC,

an Arkansas corporation, as a party plaintiff in the action.

After the disposition of numerous motions and interlocutory matters, the instant case was set for trial by the District Court on January 13, 1969. The trial date was subsequently canceled, and all the parties respondent were permitted to amend their answers to allege that the action was barred by the applicable statute of limitations. All the respondents then moved for summary judgment. The district court granted the motions, dismissing the complaint on the ground that the Arkansas Blue Sky Law two (2) year limitations of actions provision, providing for statutory civil liability under that Act, was applicable to an implied civil liability action for violation of SEC Rule 10 b-5, in Arkansas.

From both the order dismissing the common law fraud count and the summary judgment dismissing the complaint, the petitioners appealed to the United States Court of Appeals for the Eighth Circuit.

On February 24, 1970, the United States Court of Appeals for the Eighth Circuit, by panel, sustained the District Court's conclusion that the proper statute of limitations to apply to this action is found in the Arkansas Securities Act, Section 67-1256 (c) (Repl. 1966), which is also Section 410(c) of the Uniform Securities Act. The conclusion of the Court of Appeals for the Eighth Circuit is in conflict with the decisions of the United States Courts of Appeal for the First, Second, Third, Sixth, Seventh, Ninth and Tenth Circuits, and is in conflict with the only federal court decisions on point in the area of the Fourth and Fifth Circuits.

The Court of Appeals for the 8th Circuit reversed the District Court below, holding that the remedial policy expressed by Congress in enacting the securities legisla-

tion would best be served by making any statute of limitations run only from the date of the discovery of the fraud, or from the date the fraud upon reasonable inquiry should have been discovered. The Court of Appeals reinstated the common law fraud count for consideration by the trial court as a pendent jurisdiction issue.

The Court of Appeals further held that all of the parties plaintiff, except ITC, have no standing to sue in this action on the 10 b-5 claim because of the third party relationship existing between the individual investors and the respondents, who committed the fraudulent acts. This is the same question raised by certain of these same petitioners in the related case before this Court on petition for writ of certiorari in Case No 1483 (October Term, 1969).

The Court of Appeals remanded this case to the District Court with instructions to determine at trial when the alleged fraud was discovered, or should have been discovered, in order to decide whether the two year Arkansas Blue Sky Statute of Limitations is a bar to the 10 b-5 claim, reinstating the Arkansas common law fraud action, at least until such time as the District Court determines whether the statute of limitations stands as a bar to the 10 b-5 claim. The Court of Appeals suggested that it would probably serve the best interests of justice, and also the time and expense of litigants, to determine all claims, federal and non-federal, in one hearing, leaving the matter, however, to the discretion of the District Court.

The petitioners timely filed a petition for re-hearing which was denied on March 20, 1970. This petition for writ of certiorari seeks to review the judgment of the Court of Appeals on the limitations of action issue, and on the standing to sue requirement under Rule 10 b-5 imposed by the Court of Appeals below.

REASONS FOR GRANTING THE WRIT

1. **Class Protected and Class Obligated—Privity Requirement: Does a Securities Purchaser, Who Purchases in Reliance Upon Material Misrepresentations and Non-Disclosures of Third Party Insiders to the Transaction, Have a Rule 10 b-5 Action Against the Third Parties?**

The record on which summary judgment was rendered clearly reflects that in the Fall of 1966, and again in early 1967, the South Dakota petitioners purchased Class B, non-voting stock issued by ITC, an Arkansas corporation, also a petitioner. The purchases were accomplished through the use of instrumentalities of interstate commerce in actual reliance upon the misrepresentations and concealment of material facts, and as a result of a scheme by third parties, Sexton, Hall, Smith, Gatlin, Diamond G Ranch, and officers of The City National Bank of Fort Smith, Arkansas, and Texas Capital Corporation of Georgetown, Texas, to defraud the petitioners. The respondents misrepresented the value, and concealed other facts material to the solvency and profitability, of the assets being purchased by ITC, the corporate issuer to the petitioners, at a time when ITC had no other assets. The business assets being acquired by ITC were incorporated also. It later developed that the ITC stock, because of the worthlessness of its assets, was itself worthless at the time of purchase by the petitioners.

At the time of the petitioners' purchase of ITC stock, the sole and only announced purpose of ITC was to use the funds acquired from the individual investors to buy the assets misrepresented.

On summary judgment, it is conceded that the respondents misrepresented to the petitioners, and concealed from

the petitioners, material facts about the assets being purchased by ITC. But because the assets misrepresented were being purchased by ITC, the stock seller to the petitioners, and because the third party respondents did not sell securities directly to the petitioners, the Court below held that the purchasers did not meet the standing to sue requirement of Rule 10 b-5.

The Court of Appeals applied the same requirement to the same individuals in the related case against The City National Bank, now before this Court on petition for writ of certiorari as No. 1483. As there, this holding poses the very real and substantial questions of what class of persons is protected and what class of persons is obligated to securities investors (purchaser-seller) for violations of Rule 10 b-5, Section 10(b) of the 1934 Act.

In its holding here, the Court of Appeals below cited **Surowitz v. Hilton Hotels Corporation**, 342 F. 2d 569 (7th Cir. 1965), rev'd. on other grounds, 383 U. S. 363 (1966), at 604, as follows:

> "Where it has appeared that a corporation was the party injured by a violation of Section 10 (b) of the 1934 Act, the courts have held that a shareholder of that corporation had standing to sue only on a derivative basis."

The Court of Appeals below then noted that the individuals never indicated that they were bringing this action as a derivative suit, and quoted from its opinion in **Greater Iowa Corporation v. McLendon**, 378 F. 2d 783, 790 (8th Cir. 1967), as follows:

> "However, a breach of statutory duty does not give rise to a private cause of action to every person injured by the statutory breach. The law clearly demands that the statutory breach must cause injury

to one of the class that the statute is designed to protect."

From this statement, it is clear that the Court below is holding that the petitioners are outside the class of persons protected by Rule 10 b-5 and Section 10 (b) of the 1934 Act. The apparent reason for this holding is that the corporation, ITC, has the cause of action, and not the individual investors.

In evaluating this conclusion and its effect upon the class of persons protected, it is necessary to note certain pertinent facts present here. ITC was controlled by two individuals not involved in this action, namely, Maurice W. Markham, and his brother-in-law, Jimmy Willis. None of the petitioners were officers or directors of ITC. They were personally injured by the fraud of the third party respondents. Likewise, ITC was defrauded by the respondents. But the respondents may raise defenses against ITC that it does not have against the individual investors. For example, the "reasonable investor test" rule, created by the United States Court of Appeals for the Eighth Circuit below in the companion case also before this Court on petition for writ of certorari, limits the class of persons protected by Rule 10 b-5 (2)[1] to **conscientious** and good faith purchasers of securities.

In view of the non-office holding, non-voting shareholder position of the petitioners to ITC, their burden of investigation for reliance on the representations of the third party respondents may be less than that of ITC, the asset purchaser from the respondents. Knowledge

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[1] Both the District Court and the Court of Appeals below have construed Rule 10 b-5 as if it included the second clause only. In fact, the rule not only prohibits false representations and misleading omissions relating to the representations made, but Clause 1 prohibits the use of any device, scheme, or artifice to defraud, and Clause 3 prohibits any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

imputed to the corporation, ITC, may not be also imputed to the individual investors to commence the running of the statute of limitations on their cause of action against the persons defrauding them individually. From the standpoint of the tolling of the limitation of actions provision, and from the standpoint of complying with the "reasonable investor test" created by the Court of Appeals below in the companion case, it is very material to these petitioners that they be included within the class of persons protected by Section 10 (b) of the 1934 Act, and SEC Rule 10 b-5.

The cause of action of the corporation, ITC, is not the same as that of the petitioners. The cause of action of the corporation is against the respondents for misrepresentations in connection with the corporation's purchase of business assets directly from Hall, Sexton and Smith, who were aided and abetted by the other respondents. It is incidental, and immaterial to petitioners' position, that the business assets acquired by ITC were also incorporated. The petitioner's cause of action is against the respondents as third parties misrepresenting indirectly the value of ITC stock being purchased by the petitioners. The misrepresentation of the value of ITC stock is said to be indirect because the third party respondents misrepresented the value of the only assets acquired, or being acquired, by ITC, the value of which necessarily relates directly to the value of ITC stock itself.

It should matter not that the asset being purchased by the corporation is a race horse with a fractured leg, or a purported rare painting which is a forgery, or shares of stock in a going enterprise falsely represented to be of great value. The effect is the same in any case—a direct, or indirect, if you will, fraud against the stock purchasers in ITC.

Neither does it matter that one shareholder first bought stock on one day without fraudulent inducement, if he subsequently bought additional stock based on fraudulent inducement, contrary to Rule 10 b-5. The action for loss resulting from the fraudulent inducement should remain as his, and not merge with a corporate action which may be different and ineffectual. If the assets purchased here were not incorporated, certainly the corporation would have no Rule 10 b-5 action. Should these petitioners then be precluded from maintaining the Rule 10 b-5 action because of a lack of privity with the persons committing the fraud?

In **Hooper v. Mountain States Securities Corp.**, 282 F. 2d 195 (5th Cir. 1960), the Court of Appeals for the Fifth Circuit on the "standing to sue" issue held that the issuance of corporate stock, as here, was a "sale" within the purview of the rule. There the action was instituted by the defrauded issuer-seller. Here the action is on behalf of the defrauded purchasers.

Either the purchase or the sale of securities is expressly included within the words of the Act and the Rule. **Superintendent of Insurance of the State of New York v. Bankers Life & Casualty Co.**, 300 F. Supp. 1083 (S. D. N. Y. 1969). Accord. **Schoenbaum v. Firstbrook**, 268 F. Supp. 385 (S. D. N. Y. 1967), 405 F. 2d 200 (2d Cir. 1968), rev'd. on other grounds en banc, 405 F. 2d 215 (2d Cir. 1968). Both the purchaser and the seller should not be necessary parties litigant to the maintenance of a private civil action under Rule 10 b-5. See **Iroquois Industries, Inc. v. Syracuse China Corporation**, 417 F. 2d 963 (2d Cir. 1969); **Carroll v. First National Bank of Lincolnwood**, 413 F. 2d 353 (7th Cir. 1969), and **SEC v. American Beryillium Oil Corp.**, 303 F. Supp. 912 (S. D. N. Y. 1969). One of them might be known to be completely innocent of prohibited conduct where the transaction as here was induced by the fraudulent acts of third persons.

As stated in the companion case before this Court on petition for writ of certiorari, the substantive effect of the holding of the Court of Appeals below is to require privity between the securities purchaser and the person who, either directly or indirectly, violated Rule 10 b-5. As stated in the petition for writ of certiorari in the companion case, this requirement of privity is in conflict with decisions of the Second, Sixth and Ninth Circuit Courts of Appeal, all holding that the liability of persons participating in securities fraud, and their co-schemers, arising from violation of Rule 10 b-5, is not dependent upon privity of contract. Further research reveals that the holding below conflicts with decisions of the Fifth and Seventh Circuit Courts of Appeal, and District Court opinions in the Third and Tenth Circuits. **Brown v. Bullock**, 194 F. Supp. 207, 229 (S. D. N. Y. 1961), aff'd. without discussion of this point, 294 F. 2d 415 (2d Cir. 1961); **Iroquois Industries, Inc. v. Syracuse China Corporation**, *supra*; **SEC v. Texas Gulf Sulphur Co.**, 401 F. 2d 883, 854-855 (2d Cir. 1968) (en banc), cert. denied, sub nom., **Kline v. SEC**, 394 U. S. 976 (1969); **Hooper v. Mountain States Securities Corp.**, *supra*; **Texas Continental Life Insurance Co. v. Dunne**, 307 F. 2d 242 (6th Cir. 1960), rev'g. 187 F. Supp. 14 (W. D. Ky.); **Carroll v. First National Bank of Lincolnwood**, *supra* (agrees with 2d Circuit that these broad provisions should not be limited to frauds practiced directly on investors); **Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.**, 410 F. 2d 135 (7th Cir. 1969); **Errion v. Connell**, 236 F. 2d 447 (9th Cir. 1956); **Miller v. Bargain City U. S. A., Inc.**, 229 F. Supp. 33 (E. D. Pa. 1964); **Reynolds v. Texas Gulf Sulphur Co.**, 309 F. Supp. 548, 556 (D. Utah 1970). See **SEC v. American Beryllium Oil Corp.**, *supra* (privity or any semblance of privity has completely withered away); **Butler Aviation International, Inc. v. Comprehensive Designers, Inc.**, 307 F. Supp. 910 (S. D. N. Y. 1969); 3 Loss, **Securities Regula-**

tion, 1767-1771; Bromberg, Securities Law, Fraud, SEC Rule 10 b-5, Sections 2.5(3) and 8.5.[2]

As stated in Gadsby, **Business Organizations**, Federal Securities Exchange Act of 1934, Vol. 11A, at page 5-54:

> "The coup de grace to the privity requirement, however, seems to have been given in the Texas Continental case. (Texas Continental Life Insurance Co. v. Dunne, 307 F. 2d 242 (6th Cir. 1960), rev'g. 187 F. Supp. 14 (W. D. Ky.) This proceeding resulted from a rather lurid fraud, the plaintiff having bought its bonds from the notorious Ben Jack Cag, late of Texas, who in turn had bought the issue from the defendant in an ingenious but hardly commendable transaction involving a worthless note. There most certainly was no privity—of contract or otherwise—between the plaintiff and the underwriter which it was suing, and the Sixth Circuit Court flatly announced that there was no such requirement.
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> "It remained for Judge Herlands to sum up the situation, though in a different context, in Brown v. Bullock:
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> > 'Privity of contract between the plaintiffs and the defendants is not a fixed condition precedent to the implication of a private remedy for a statutory violation that injured the plaintiffs, members of the protected class. In that situation, privity is not an ultimate or operative fact. It is an evidentiary fact to be considered in conjunc-

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[2] See also **Thiele v. Shields**, 131 F. Supp. 416 (S. D. N. Y. 1955); **Pettit v. American Stock Exchange**, 217 F. Supp. 21 (S. D. N. Y. 1963); **H. L. Green v. Childree**, 185 F. Supp. 95 (S. D. N. Y. 1960); **Brenan v. Midwestern United Life Insurance Co.**, 259 F. Supp. 673 (N. D. Ind. 1966); **Bredehaft v. Cornell**, 260 F. Supp. 557 (D. Ore. 1966); comment: Civil liability under a Section 10 (b) and Rule 10 b-5; a suggestion for replacing the doctrine of privity, 74 Yale L. J. 658, 661-667 (1965).

> tion with other material facts in determining whether the relationship (such as it is) between the plaintiffs and the defendants and the nature of the particular acts and transactions involve the duty created by the statute.' (Brown v. Bullock, 194 F. Supp. 207, 229 (S. D. N. Y. 1961), aff'd. without discussion of this point, 294 F. 2d 415 (2d Cir. 1961)."

The resolution of this privity or "standing to sue" requirement appears essential to effective enforcement of the Securities Exchange Act of 1934, and Rule 10 b-5 promulgated thereunder. If persons may defraud a securities purchaser by doing so through the medium of an innocent corporate issuer without violating Rule 10 b-5, then the courts have opened wide again the doors to uncontrolled stock fraud in interstate commerce. Such is not the Congressional intent announced in the Securities Act. It is not difficult to imagine, it is even common, that in "con games" the guilty party will beguile one innocent party into soliciting others to invest with the first one duped, and the "con man" walks off with all the funds. If privity is required between the protected class and the obligated class, then all any stock fraud artist need do to avoid 10 b-5 is first to entice, on a local face to face basis, an innocent corporation into floating a public issue based upon representations as to the value of assets to be sold to the issuing corporation by the third person. No 10 b-5 action would exist in a corporate issuer acquiring unincorporated assets. True, the corporation may have a separate cause of action for common law fraud, if it can proye the requisite elements, or circumstances justifying application of the constructive fraud doctrine. But the 10 b-5 action of the individual stock purchaser in interstate commerce, purchasing in reliance upon the fraudulent representations, scheme and conduct

of the third person, is lost because he has no standing to sue the one actually responsible for the fraud!

The very recent and lucid opinion of the United States District Court for the Southern District of New York in the case of **Superintendent of Insurance of the State of New York v. Bankers Life & Casualty Co.**, *supra*, summarizes the "standing to sue" requirement as follows:

> "The securities acts, and especially the 1934 Act, were intended to prevent fraud and deception, manipulation and inadequate disclosure in the dissemination and trading of securities. The securities acts are not so much concerned with fraud *per se* as with the effect of fraud upon investors and the public interest in maintaining free and open securities markets. 1934 Act; Section 2 (3), 15 U. S. C., Section 78(b)(3); Schoenbaum v. Firstbrook, 405 F. 2d 200, 212 (2d Cir.), rev'd. en banc, 405 F. 2d 200, 212 (2d Cir. 1968); SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833, 858-860 (2d Cir. en banc (1968)); cf. A. T. Brod & Co. v. Perlow, supra.
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> "In order to sustain a complaint alleging fraud under 10 (b) of the 1934 Act, it must appear with reasonable clarity from the face of the complaint either (1) that a purchase or sale of securities is at the crux of a fraudulent scheme; or (2) that inducing a purchase or sale of securities is the object of a fraudulent scheme; or (3) that fraudulent statements, misstatements, or omissions are made in a manner which is reasonably calculated to influence the investing public, or are of the sort which the reasonable investing public might rely upon; or (4) that the trading process is abused through potential market manipulation or the spread of watered stock."

It is submitted that Congressional intent enunciated in the Securities Acts, and in the better reasoned cases in the

other Courts of Appeal, justify the elimination of privity as a requirement to a Rule 10 b-5 action. If the consequences of fraud and misrepresentations of the stock sellers, and of their aiders and abettors, can be avoided by the injection into the scheme of a separate corporate structure, and by the direction of the misrepresentations to non-voting, non-office holding investors in the intermediary corporate structure, the preventative and remedial effects of the 10 b-5 cases on securities fraud will be destroyed.

The application of the requirements for the tolling of the statute of limitations to the corporation, and the application of the "reasonable investor test", created in the companion case to this Rule 10 b-5 action, may effectively destroy any corporate cause of action against the persons committing the fraud. On the other hand, the independent cause of action of the individual investors in ITC stock may not be so barred because of their lack of direct legal relationship to the Arkansas assets purchased, their non-voting, non-office holding position in ITC, and their residence hundreds of miles away in the State of South Dakota.[3]

It would appear that the petitioners are some of the very persons who Congress intended to protect by its enactment of the Federal Securities Acts. They are persons

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[3] The Court below found that the individual investors have no standing to sue because only ITC was a party to the agreement of September 9, 1965, where it contracted to purchase assets from the respondents. Yet the same Court states in footnote 3 at page 3 of its opinion that the evidence is clear that Markham, president of ITC, was the agent for the South Dakota investors at the time the option agreement was signed and at the time the purchase was concluded on January 10, 1966. The Court of Appeals then concluded that this would make Markham the agent for the South Dakota investors when he personally took charge of the business assets acquired on September 9, 1965. (No assets were in fact acquired until November of 1965.) This conflicting finding of fact defies reason and justice.

who have been defrauded by respondents, either directly or indirectly, through the use of instrumentalities of interstate commerce in connection with their purchase of ITC securities. They fall squarely within the plain language of the rule!

2. **Conflicting Application of Limitation of Actions Provisions: Should Defrauded Securities Investors in Interstate Commerce Be Prevented From Maintaining a Rule 10 b-5 Action Because of Uncertainty Created by Conflicting Decisions of United States Courts of Appeal as to the Characterization of a Rule 10 b-5 Action and as to the Basis for Selection of the Applicable Statute of Limitations?**

The Court below applied as the post appropriate limitation of action provision the special two-year limitations period contained in the Arkansas Blue Sky Law civil liabilities section which purports to be applicable only to the limited civil liability and remedy created by that section of the Act itself. This selection was made on the announced basis that Arkansas common law actions for fraud require scienter while 8th Circuit 10 b-5 (2) actions and Arkansas Blue Sky Law actions do not. The Court below characterizes the 10 b-5 action as being in the nature of an implied Arkansas Blue Sky Law action! The section of the Blue Sky Law containing the limitations provision applied expressly prohibits implied civil actions from violations of that Act!

The Court of Appeals for the Eighth Circuit stands alone in the United States in applying a state Blue Sky Law limitation period to the implied civil liability action under SEC Rule 10 b-5. The Court of Appeals below not only stands alone, it stands in conflict with the Courts of Appeal for the 1st, 2d, 3d, 6th, 7th, 9th and 10th Circuits, and in conflict with the only decisions rendered by the

federal courts in the 4th and 5th Circuits of the United States. The question of the appropriate period of limitation has been considered in the following cases in the Circuits indicated:

First Circuit.

Janigan v. Taylor, 344 F. 2d 781 (1st Cir. 1965) (two year fraud period applied, Mass. G. L., c. 260, Section 2 A).

Second Circuit.

Fischman v. Raytheon Mfg. Co., 188 F. 2d 783 (2d Cir. 1951) (6 year New York fraud period applied—N. Y. Civil Practice Act, Sections 4.0 (2) and (5));

Klein v. Bower, 421 F. 2d 338 (2d Cir. 1970) (6 year New York fraud period applied, footnote 4, page 343);

Klein v. Spear, Leeds & Kellogg (U. S. D. C. S. D. N. Y. 1969) (6 year New York fraud period applied);

Moerman v. Zipco, Inc. et al., 302 F. Supp. 439 (E. D. N. Y. 1969) (Held that since complaint filed within 2 years, the statute of limitations is no defense, citing N. Y. CPLR, Section 202; Connecticut General Statutes, Section 52-Section 77, **Marth v. Industrial Incomes, Inc.**, 290 F. Supp. 755, 757 (S. D. N. Y. 1968));

Shapiro v. Schwamm, 279 F. Supp. (S. D. N. Y. 1968) (6 year fraud period applied);

Marth v. Industrial Incomes, Inc., 290 F. Supp. 755 (S. D. N. Y. 1968) (The statute of limitations applicable to New York State common law fraud is six years. Since the limitations period for a Section 10 (b) claim is borrowed from the governing state fraud statute, the six-year period is likewise applicable. **Fischman v. Raytheon Mfg.**

Co., supra; **Glickman v. Schweikart & Co.**, 242 F. Supp. 670, 674 (S. D. N. Y. 1965); 3 Loss, Securities Regulations, 1774, 1961 ed.)).

Third Circuit.

Tobacco and Allied Stocks v. Transamerica Corp., 143 F. Supp. 323 (D. C. Del. 1956), aff'd 244 F. 2d 902 (3d Cir. 1957) (Rule 10 b-5 is founded on common law fraud. But action under X-10 B-5 is historically an action on the case—three year period applied rejecting period for "action based on statutes");

Livingston v. Weis, Voisin, Cannon, Inc., 294 F. Supp. 676 (D. C. N. J. 1968) (period in Securities Act for violation of specific provisions of act not applicable to implied action for violation of other provisions of act).

Fourth Circuit.

Baumel v. Rosen, 283 F. Supp. 128 (D. C. Maryland 1968) (Maryland 3 year period for fraud applied to 10 b-5 action).

Fifth Circuit.

Azalea Meats, Inc. v. Muscat, 246 F. Supp. 780 (S. D. Fla. 1965) (In Florida, action brought under a statute, even though similar to a common law action, is governed by three-year period for action upon liabilities created by statute).

Sixth Circuit.

Charney v. Thomas, 372 F. 2d 97 (6th Cir. 1967) (six year period for fraud governs, not two-year period covering liability created for violation of Michigan Blue Sky Law);

Donnelly v. Balkwill, 174 F. Supp. 49 (N. D. Ohio 1959), aff'd per curiam 279 F. 2d 685 (6th Cir.

1960) (4 year limitation period for fraud applicable to 10 b-5 action, rather than the limitation applicable to actions based upon a liability created by statute).

Seventh Circuit.

Morgan v. Koch, 419 F. 2d 993 (7th Cir. 1969) (parties agreed that Indiana six year fraud statute governs 10 b-5 action. Burns' Indiana Stat. Anno., Section 2-601 (1967 Replacement));

Northern Trust Co. v. Essaness Theater Corp., 103 F. Supp. 954, 966-968 (N. D. Ill. 1952) (five-year period for fraud applies).

Eighth Circuit.

Vanderboom et al. v. Sexton et al., 422 F. 2d 1233 (8th Cir. 1970) (two year period covering seller liability created for statutory Blue Sky Law violations governs, rather than three year period for fraud).

Ninth Circuit.

Fratt v. Robinson, 203 F. 2d 627 (9th Cir. 1953) (Washington three-year fraud period applies, rather than two year period covering liability created by statute);

Errion v. Connell, 236 F. 2d 447 (9th Cir. 1956) (three-year fraud period from date of discovery applied without discussion);

Turner v. Lundquist, 377 F. 2d 44 (9th Cir. 1967) (California three year period applied from Cal. Code of Civil Procedure, Sec. 338(4), citing **Errion v. Connell**, supra);

Sackett v. Beaman, 399 F. 2d 884 (9th Cir. 1968) (California three-year period for fraud applied);

Hecht v. Harris, Upham & Co., 283 F. Supp. 417

(N. D. Cal. 1968) (California three-year period for fraud applied).

Tenth Circuit.

Chiodo v. General Waterworks Corporation, 380 F. 2d 860 (10th Cir. 1967) (Utah three year period for fraud applies);

Trussell v. United Underwriters, Ltd., 228 F. Supp. 757 (D. Col. 1964) (Colorado three year period for fraud applies rather than two year period covering liability created for Blue Sky Law violations);

Reynolds v. Texas Gulf Sulphur Company, 309 F. Supp. 548 (D. Utah 1970) (Utah three year period for fraud applies);

See 3 Loss, **Securities Regulation**, op. cit., supra, 1774; Fleischer, "Federal Corporation Law": an assessment, 78 Harv. L. Rev. 1146, 1153 (1965); Note, 74 Yale L. J. 658, 685-686 and n. 103 (1965).

The Court of Appeals below admits that Rule 10 b-5 is not the same as Ark. Stats., Section 67-1256, the express civil liabilities section of the Arkansas Securities law containing the special two year limitation period applied to the Rule 10 b-5 action here. The Court of Appeals correctly concedes that Ark. Stats., Section 67-1256, is comparable to Section 12 (2) of the Securities Act of 1933, a part of the language of which is included in clause 2 only of Rule 10 b-5. The Court below also correctly concedes that **a 10 b-5 claim is** a legal action based upon **an implied civil remedy in tort.**

The Court of Appeals concludes that common law fraud in Arkansas apparently requires scienter, whereas misrepresentations under Arkansas Blue Sky Law are actionable if either intentionally or negligently made. From this, the Court reasons that since a Rule 10 b-5 action

in the Eighth Circuit also applies to intentional and negligent misrepresentations, the special limitation of action provision in the Arkansas Blue Sky Law is the appropriate one to apply in this case.

The Courts below choose to ignore the fact that the limitation provision of Section 67-1256 applies only to violations of that particular section, and to no other civil actions. The section expressly prohibits implication of other civil actions for violation of the Arkansas Securities Act. The limitation provision is not general, but special, applying only to actions by purchasers (not sellers) buying securities on the basis of untrue statements of material fact, or half-truths not known to the buyer, provided the seller does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known of the untruth or omission. Thus, an innocent misrepresentation, not carelessly or recklessly made, is not actionable under the Arkansas Blue Sky Law, further distinguishing it from an 8th Circuit Rule 10 b-5 action: This obvious distinction, crucial to the reasoning of the Courts below, is overlooked.

Neither do the Courts below give consideration to the fact that when the Arkansas Courts as a matter of public policy choose to apply the constructive fraud doctrine permitting recovery on innocent misrepresentations of fact, the same three year limitation of action provision is applied as that governing actual fraud requiring scienter or reckless disregard for the truth. The federal implication of an action for violation of Rule 10 b-5 results as a matter of public policy, as does the Federal court's statement of the proper application of constructive fraud in Arkansas.

The very action before the Court in this case existed by implication in the federal case law below long prior to the enactment in 1959 of the Section of the Arkansas Se-

curities Act containing a special limitation of action provision. The 10 b-5 action existed long before the legislature of the State of Arkansas said in the section containing the special limitation of action provision that the rights and remedies created by the act are in addition to any other rights or remedies existing at law or equity.

The statute of limitations for this action, absent the federal jurisdictional means, would be the general three year statute applicable to all civil actions based on implied liability. Clearly, this three year limitation period would be applied by the Arkansas courts to all securities actions not brought under the narrow coverage of Section 67-1256. Contrary to the characterization of a 10 b-5 action by the Court of Appeals below, no implied civil remedy in tort can be brought under the Arkansas Blue Sky Law. The special limitation of action period contained in the section for violation of the specific provisions of that section has far less logical connection to an implied federal securities action for damages than does the limitation provision contained in the 1933 Securities Act for violation of Section 12(2) of that federal act. **No final decision in the United States Federal Court system has applied either the limitations period for violation of Section 12(2) of the 1933 Securities Act, or the limitation period for a state Blue Sky Law action to a Rule 10 b-5 action, except the Court of Appeals for the Eighth Circuit in the case now under consideration for review.**

The issue presented here is primarily one of the proper characterization of a Rule 10 b-5 private civil action, and then the selection from the choices available of the limitation period for bringing this class action which best effectuates federal policy.

Numerous authorities have discussed the quantum of proof required to sustain a cause of action under Rule

10 b-5, and how a cause of action under Rule 10 b-5 differs from a cause of action for common law fraud. See discussion in **Baumel v. Rosen**, supra; **Kahan v. Rosenstiel**, 300 F. Supp. 447 (D. Del. 1969); **Lehigh Valley Trust Co. v. Central National Bank of Jacksonville**, supra; **Moerman v. Zipco, Inc.**, 302 F. Supp. 439 (E. D. N. Y. 1969); **Speed v. Transamerica Corp.**, 99 F. Supp. 808 (D. Del.), aff'd., 235 F. 2d 369 (3rd Cir. 1956); **Ellis v. Carter**, 291 F. 2d 270 (9th Cir. 1961), and **Royal Air Properties, Inc. v. Smith**, 312 F. 2d 210 (9th Cir. 1962); **Kohler v. Kohler Co.**, 208 F. Supp. 808 (D. C. Wis. 1962), aff'd., 319 F. 2d 634 (7th Cir. 1963). Many courts differ on the requirements for scienter, reliance and materiality. However, here the complaint, supported by affidavits in opposition to summary judgment, establishes materiality, scienter and reliance in fact, to the substantial damage of the petitioners-investors.

The selection of the most appropriate limitation of actions provision should not turn on the absence of a scienter requirement in a Rule 10 b-5 (2) action, where as here scienter exists, and the three-year limitation period applies to actions with scienter as well as actions without scienter.

This is a private civil action for damages based on liability **implied** from violation of SEC Rule 10 b-5 promulgated under Congressional authority contained in Section 10 (b) of the Securities Exchange Act of 1934. **Janigan v. Taylor**, 344 F. 2d 781 (1st Cir. 1965); **Fratt v. Robinson**, 203 F. 2d 627 (9th Cir. 1953), 37 A. L. R. 2d 636; "The prospects for Rule X-10 B-5: an Emerging Remedy for Defrauded Investors", 59 Yale L. J. 1120, 1133; "Implied Liability Under the Securities Exchange Act", 61 Harv. L. R. 858.

It is historically an action on the case rather than an action created by statute, and includes within its ambit

at least actual and constructive securities fraud committed through the use of the mails, a national exchange, or other instrumentality of interstate commerce. See **Tobacco and Allied Stocks v. Transamerica Corp.**, 143 F. Supp. 323, 327, aff'd 244 F. 2d 902 (3d Cir. 1957); **Connelly v. Balkwill**, 174 F. Supp. 4963 (N. D. Ohio 1959); **Trussell v. United Underwriters, Ltd.**, 228 F. Supp. 757 (D. C. Col. 1964); **Kardon v. National Gypsum Co.**, 69 F. Supp. 512 (E. D. Pa. 1946). No authority need support the known fact that actual and constructive fraud actions preexisted SEC Rule 10 b-5.

The class of persons protected includes defrauded purchasers and sellers. **Hooper v. Mountain States Securities Corp.**, 282 F. 2d 195 (5th Cir. 1960), cert. den. 365 U. S. 814, 81 S. Ct. 695, 5 L. Ed. 2d 693 (1961); **Reynolds v. Texas Gulf Sulphur Company**, 309 F. Supp. 548 (1970). **Carroll v. First National Bank of Lincolnwood**, 413 F. 2d 353 (7th Cir. 1969). (The class of persons protected includes all who are victims of the securities fraud.) **Fischman v. Raytheon Mfg. Co.**, 188 F. 2d 783, 786-787 (2d Cir. 1951).

The gravamen of the implied 10 b-5 action is securities fraud. **SEC v. National Securities, Inc.**, 393 U. S. 453, 89 S. Ct. 564, 21 L. Ed. 668 (1968); **Swanson v. American Consumer Industries, Inc.**, 415 F. 2d 1326 (7th Cir. 1969); **Lehigh Valley Trust Company v. Central National Bank of Jacksonville**, 409 F. 2d 989 (5th Cir. 1969); **Fischman v. Raytheon Mfg. Co.**, supra; **Fratt v. Robinson**, supra; **Superintendent of Insurance of the State of New York v. Bankers Life & Casualty Co.**, supra; **Carroll v. First National Bank of Lincolnwood**, supra; **Reynolds v. Texas Gulf Sulphur Company**, supra.

Federal jurisdiction attaches to the fraudulent acts when the use of an instrumentality of interstate commerce is involved in the fraud. Section 27 of the 1934 Act (15

U. S. C., Section 78aa); **Connelly v. Balkwill**, 174 F. Supp. 49 (N. D. Ohio 1959), aff'd 279 F. 2d 685 (6th Cir. 1960). **Myzel v. Fields**, 386 F. 2d 718, 727-728 (8th Cir. 1967), cert. denied 390 U. S. 951 (1968); **Matheson v. Armbrust**, 284 F. 2d 670, 673 (9th Cir. 1960), cert. denied 365 U. S. 870 (1961). Bromberg, Securities Law, Fraud, SEC Rule 10 b-5, Section 11.2.

But the use of an instrumentality of interstate commerce *per se* is not denounced by the Rule, it is the fraud that offends. The Rule denies the use of instrumentalities of interstate commerce in connection with the securities fraud. **Fratt v. Robinson**, supra.

The District Court of Maryland in **Baumel v. Rosen**, 283 F. Supp. 128 (D. C. Maryland 1968), at page 140, succinctly summarized the cases and the differences between an action under Rule 10 b-5 and an action under common law fraud. That Court states that the majority view seems clearly to indicate that something less than common law fraud is necessary to establish a cause of action under Rule 10 b-5. Likewise, something less than common law fraud is necessary to establish constructive fraud. The District Court of Maryland also aptly states "that the information not disclosed or mis-stated, in order to constitute a violation of Rule 10 b-5 must be material", and that most of the authorities require some reliance by the plaintiff.

It seems clear that the first and third clauses of Rule 10 b-5 embody all forms of fraud, any scheme or device, anything that operates or would operate as a fraud or deceit upon a member of the protected class. 10 b-5 is not clause 2 alone. Yet the case at bar has construed 10 b-5 as consisting of clause 2 alone, correctly holding as a matter of policy that scienter is not required for a clause 2 action. But the complaint alleges, and the facts before the Court on summary judgment reflect, a cause of ac-

tion for violation of clauses 1 and 3 of 10 b-5 which includes actual fraud.

The Investment Advisors Act of 1940 (15 U. S. C. (Supp. IV), Section 80 b-6) repeats the language of clauses 1 and 3 of Rule 10 b-5, but omits the language of clause 2, proscribing misrepresentations and half-truths. This Court, in dealing with the meaning and scope of the language of clauses 1 and 3, treated clause 2 as surplusage, holding that clauses 1 and 3 condemned non-disclosures of material facts. **SEC v. Capital Gains Research Bureau**, 375 U. S. 180, 80 S. Ct. 275, 11 L. Ed. 2d 237 (1963).

This Court there reviewed the history of the securities industry, legislation, including the Securities Exchange Act of 1934, and the evils which the legislation was designed to curb or eliminate, and stated:[4]

> "A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'it requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. Silva v. New York Stock Exchange, 373 U. S. 341, 366, 10 L. Ed. 2d 389, 405, 83 S. Ct. 1246."[5]
>
> "It would defeat the manifest purpose of the Investment Advisors Act of 1940 for us to hold, therefore,

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[4] Id. 375 U. S. at 186-187, 192.

[5] This philosophy is substantially rejected by the "reasonable investor" test created by the Court of Appeals below in the companion case of Vanderboom, et al. v. The City National Bank of Fort Smith, now in this Court on petition for writ of certiorari as No. 1483. City National Bank of Fort Smith, Ark. v. Vanderboom, 422 F. 2d 221 (8th Cir. 1970).

that Congress, in empowering the Courts to enjoin any practice which operates 'as a fraud or deceit' intended to require proof of intent to injure and actual injury to clients.

"This conclusion, moreover, is not in derogation of the common law of fraud, as the District Court and the majority of the Court of Appeals suggested. To the contrary, it finds support in the process by which the courts have adapted the common law of fraud to the commercial transactions of our society. It is true that at common law intent and injury have been deemed essential elements in a damage suit between parties to an arm's-length transaction (fn. 39)."

At footnote 39, this Court continued:

"Even in a damage suit between parties at an arm's-length transaction, the intent which must be established need not be an intent to cause injury to the client, as the courts below seem to have assumed. 'It is to be noted that it is not necessary that the person making the misrepresentation intend to cause loss to the other or gain a profit for himself; it is only necessary that he intend action in reliance on the truth of his misrepresentations.' 1 Harper and James, The Law of Torts (1956), 531. '(T)he fact that the defendant was disinterested, that he had the best of motives, and that he thought he was doing the plaintiff a kindness, will not absolve him from liability, so long as he did in fact intend to mislead.' Prosser, Law of Torts (1955), 538. See 3 Restatement, Torts (1938), Section 531, Comment b, illustration 3."

In discussing the development of common law fraud in the **SEC v. . . . Capital Gains Research Bureau** case, this Court observed:[6]

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[6] **SEC v. Capital Gains Research Bureau,** supra, 375 U. S. at 193-194, 195.

"The content of common-law fraud has not remained static as the courts below seem to have assumed. It has varied, for example, with the nature of the relief sought, the relationship between the parties, and the merchandise in issue.

"It is not necessary in a suit for equitable or prophylatic relief to establish all the elements required in a suit for monetary damages.

" 'Law had come to regard fraud . . . as primarily a tort, and hedged about with stringent requirements, the chief of which was a strong moral, or rather immoral elements, while equity regarded it, as it had all along regarded it, as a conveniently comprehensive word for the expression of a lapse from the high standard of conscientiousness that it exacted from any party occupying a certain contractual or fiduciary relation towards another party' (fn. 41).

" 'Fraud has a broader meaning in equity (than at law) and intention to defraud or to misrepresent is not a necessary element' (fn. 42).

" 'Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another' (fn. 43)."

* * * * * * *

"Thus, even if we were to agree with the courts below that Congress had intended, in effect, to codify the common-law of fraud in the Investment Advisors Act of 1940, it would be logical to conclude that Congress codified the common law 'remedially' as the courts had adapted it to the prevention of fraudulent securities transactions by fiduciaries, not 'technically' as it has traditionally been applied in damage suits

between parties to arm's-length transactions involving land and ordinary chattels.

"The foregoing analysis of the judicial treatment of common-law fraud reinforces our conclusion that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit' upon a client, did not intend to require proof of intent to injure and actual injury to the client. **Congress intended the Investment Advisors Act of 1940 to be construed like other securities legislation 'enacted for the purpose of avoiding frauds'** (fn. 47), **not technically and restrictively, but flexibly to effectuate its remedial purposes.**" (Emphasis supplied.)

As stated in the very recent case of **Reynolds v. Texas Gulf Sulphur Company**, supra, 309 F. Supp. 548 (D. Utah 1970):

"In the case of Speed v. Transamerica Corp., supra, the Court held that an implied misrepresentation can be just as fraudulent as an express one, that the three subparagraphs of Rule 10 b-5 are mutually supporting and not mutually exclusive, and that a defendant's breach of duty to disclose accordingly can be viewed as a violation of all three sub-paragraphs, i. e., (1) a device, scheme, or artifice to defraud, (2) an implied misrepresentation or misleading omission, and (3) an act, practice or course of business which operates or would operate as fraud."

Why then should the courts below be permitted to characterize a Rule 10 b-5 action as a partial clause 2 action only for the purpose of choosing the state limitation of action provision?

The plain language of Rule 10 b-5 must at least include within the ambit of its broad anti-fraud provisions actual fraud as well as legal or constructive fraud committed

with the jurisdictional means in connection with the purchase or sale of a security. **Carroll v. First National Bank of Lincolnwood**, supra, **A. T. Brod & Co. v. Perlaw**, 375 F. 2d 393 (2d Cir. 1967). ("all fraudulent schemes in connection with the purchase or sale of securities, whether the artifice employed involves a garden type variety of fraud, or present a unique form of deception.") **Trussell v. United Underwriters, Ltd.**, supra, **Connelly v. Balkwill**, 174 F. Supp. 49 (N. D. Ohio 1959), aff'd 279 F. 2d 685 (6th Cir. 1960).

Both actual fraud requiring scienter, and legal or constructive fraud actions requiring no scienter, existed in Arkansas prior to the adoption of the Arkansas Securities Act in 1959. Act No. 254, Acts of Arkansas, 1959 (Ark. Stats., Sec. 67-1235, et seq.). **Levinson v. Treadway**, 78 S. W. 2d 59, 190 Ark. 201 (1935); **Kersh Lake Drainage District v. Johnson**, 157 S. W. 2d 39, 203 Ark. 315 (1941), **Standard Motor Finance Company v. Mitchell Auto Company**, 293 S. W. 1026, 173 Ark. 875, 57 A. L. R. 877 (1927), **Stewart v. Clark**, 115 S. W. 2d 887, 195 Ark. 943 (1938), **Arkansas Valley Compress & Warehouse Co. v. Morgan**, 229 S. W. 2d 133, 217 Ark. 161 (1950), **Fausett & Company, Inc. v. Bullard**, 229 S. W. 2d 490, 217 Ark. 176 (1950). See also **Clay v. Brand**, 365 S. W. 2d 256, 236 Ark. 236 (1963). ("The misrepresentation of a material fact is actionable fraud"); **Lane v. Rachel**, 389 S. W. 2d 621, 239 Ark. 400 (1965). ("Neither actual dishonesty of purpose nor intent to deceive is an essential element of constructive fraud.") The constructive fraud doctrine was recognized, but not applied, in **Arkansas State Highway Commission v. Clemmons**, 428 S. W. 2d 280, 224 Ark. 1124 (1968), and in **Bridges v. United Savings Association of Fort Smith**, 438 S. W. 2d 303, ... Ark. ... (1969). (Respondent, Sam Sexton, Jr., urged the doctrine in his own behalf in an effort to defeat his liability on a mortgage obligation assumed by him.)

Contrary to the conclusion of the District Court and the Court of Appeals below, Arkansas judges decide cases based on the inclusion of constructive fraud in the Arkansas body of law as evidenced not only by the above cited cases, but by two cases in the Chancery Court of Sebastian County, Arkansas, Fort Smith District, where counsel for petitioners received two favorable decisions holding squarely that an innocent misrepresentation is enough. **Edson, Jorden & Arko Fence Company, Inc. v. Warmack & Arkhoma, Inc.**, case No. 1790, **Crone v. Nielsen**, case No. 5827 (1970).

Prior to this case, it was thought that there were only two statutes of limitation in Arkansas available for selection and application to a Rule 10 b-5 action. One is the five-year period applicable to all actions not included in the other limitation of action provisions. Ark. Stats., Sec. 37-213. It is under this section that the cases pertaining to fraud appear in volume 3B, Arkansas Statutes, 1947 annot., official ed. (1962 Repl.). The other statute of limitation is the three-year period applicable to all action founded upon any contract, obligation, or liability not in writing, and to **all actions on the case founded on any** contract, or **liability**, express or **implied.** Ark. Stats., Sec. 37-206. It is this statute which the Supreme Court of Arkansas has clearly and more recently held governs fraud action. **White v. McBride**, 245 Ark. 587, 434 S.W. 2d 79 (1968).

It was not until a few days before the date set for trial of this cause in the District Court below that it occurred to the respondents to argue that the special two-year Blue Sky Law limitation of action provision applied to a 10 b-5 action. The express civil liabilities section containing the special limitation of action provision provides that **the limitation of action period applies only to actions under that section.** Ark. Stats., Sec. 67-1256 (c). It reads in pertinent part as follows:

"No person may sue under this section more than two (2) years after the contract of sale. . . ."

It is this quoted provision which the Courts below have applied to a Rule 10 b-5 action.

This action is for damages by the victims of fraud in connection with their purchase of securities still owned by them, but which are worthless. They have pleaded alternatively for recission, but because of events subsequent to the fraud, damages are sought. An action for damages by a defrauded stock purchaser retaining the worthless securities purchases will not lie under Section 67-1256 of the Arkansas Securities Act. And that special limitation of action period has no relevance to this federal action.

Limitations on federally created rights to sue are governed by limitations law of the state where the crucial combination of events transpired. **Cope v. Anderson**, 67 S. Ct. 1340, 331 U. S. 461, 91 L. Ed. 1602 (1947), **Holmberg v. Armbrecht**, 327 U. S. 392, 66 S. Ct. 582, 90 L. Ed. 743 (1946).

In choosing among state statutes of limitations to apply in actions under federal law, the federal courts must look to state court interpretations of the statutes "to see where the claim fits into the state scheme." **Moviecolor Limited v. Eastman Kodak Co.**, 288 F. 2d 80, 90 A. L. R. 2d 252 (2d Cir.), **cert. denied**, 368 U. S. 821, 82 S. Ct. 39, 71 L. Ed. 2d 26 (1961) see 3 Loss, Securities Regulations 1774 (1961 ed.); **Klein v. Bower**, 421 F. 2d 338 (2d Cir. 1970).

Statutes of limitations are designed primarily to assure fairness to defendants. They promote justice by preventing surprises through revival of claims that have been allowed to slumber until evidence has been lost, memories

have faded, and witnesses have disappeared. **Burnett v. New York Central Railway Company**, 85 S. Ct. 1050, 380 U. S. 424, 13 L. Ed. 2d 941 (1965). No such factors exist here. All of these petitioners, except ITC, have been seeking relief in court since the Fall of 1967. Only the defendants were surprised when after trial setting they learned that a two year limitation period might be applied to a 10 b-5 case in the Western District of Arkansas. Theretofore, all Arkansas lawyers knowledgeable in securities law had assumed that either the three or five year statutes for fraud governed these actions in Arkansas. This assumption was quite reasonable in view of the abundance of precedent throughout the United States applying the fraud limitation period to 10 b-5 actions.

The policy of repose, designed to protect defendants, is frequently outweighed where the interests of justice require a vindication of plaintiffs' rights. **Burnett v. New York Central Railway Company**, supra, **Belton v. Traynar**, 381 F. 2d 82 (4th Cir. 1967). These respondents should be required to disgorge the fruits of their deliberate fraud on the bases of facts developed and presented through investigation of the parties and interested public agencies, including the SEC, concerned with related matters not before the Court, but bearing on the operative facts of the securities transaction, and the value of the securities purchased. The respondents must meet the timely claims of the petitioners for common law fraud reinstated by the Court of Appeals below. No reason exists in connection with a policy of repose to expose these petitioners to a new round of litigation in state court should the District Court below decide that pendent jurisdiction of the common law fraud claim will not be retained, if it is first determined that the two year Blue Sky Law limitation period bars the federal claim. The petitioners seek the establishment by this Court of a uniform characterization of a Rule 10 b-5 claim for application throughout the

nation to prevent the gross waste of resources of both the courts and the parties in this and future cases turning on the characterization of a 10 b-5 action for application to the appropriate limitations period.

Doubt as to which of two or more statutes of limitation applies to a particular action or proceeding will generally be resolved in favor of the application of the statute containing the longest limitation. **Jefferson v. Nero,** 280 S. W. 2d 884, 225 Ark. 302 (1954). **Matthews v. Travelers Indem: Ins. Co.,** 432 S. W. 2d 485, 245 Ark. 247 (1968). Thus, any doubt here should be resolved in favor of the three or five year statutes.

A statute of limitation is applicable only to those actions that are specifically enumerated therein. **Gibson v. Gibson,** 402 S. W. 2d 647, 240 Ark. 827 (1966), appeal after remand 424 S. W. 2d 871, 244 Ark. 327 (1968). Clearly an action for damages implied from a violation of SEC Rule 10 b-5 retaining the securities purchased is not specifically enumerated in the express civil liabilities section of the Arkansas Blue Sky Law. Ark. Stat., Section 67-1256. And the Arkansas legislature clearly manifests its intent that no such construction shall be given the Arkansas Securities Act in stating in sub-section (h) of Section 67-1256:

> "The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or equity, but this Act does not create any cause of action not specified in this section or section 4 (c) (Section 67-1232 (c))."

Arkansas actions based on implied liability or fraud have the same three year statute of limitations. Ark. Stats., Section 37-206; **Magale v. Fomby,** 201 S. W. 278, 132 Ark. 289 (1918); **Hazel v. Sharum,** 32 S. W. 2d 315, 182 Ark. 557 (1930); **Burton v. Tribble,** 70 S. W. 2d 503,

189 Ark. 58 (1934) (applies to all tort actions not otherwise limited by law); **Percy v. Cockrill**, 53 F. 872, 4 C. C. A. 73 (1893); **Futrall v. City of Pine Bluff**, 87 F. 2d 711 (8th Cir. 1937) (action to recover money paid through honest mistake, in absence of fraud is action founded on implied contract or liability, and is governed by three year limitation statute). **Sommer v. Nakdimen**, 97 F. 2d 715, 721 (8th Cir. 1938) (appeal from W. D. Ark., three year period applied to implied contract); **Air Leases, Inc. v. Baker**, 167 F. Supp. 145 (W. D. Ark. 1958) (fraud and deceit); **White v. McBride**, 434 S. W. 2d 79, 245 Ark. 587 (1968) (approving **Air Leases, Inc. v. Baker**, supra). But see **Yudin v. Carroll**, 57 F. Supp. 793 (W. D. Ark 1944) (action against executor based upon decedent's alleged fraud and conspiracy to rob plaintiffs was subject to five year general statute governing actions not included in other limitation provisions.)

In proposing changes for Rule 10 b-5, Professor Bromberg, author of Securities Law, Fraud, Rule 10 b-5, Section 12.9, page 284, states:

> "Thus, in statute of limitations a plaintiff cannot only avoid the federal periods, but often, using the broad venue, choose among several state provisions. A federal time limit for a federally created but highly mobile claim has obvious logic and appropriateness. But 10 b-5 cases indicate that one year is too short. **Three years seems about right**"[7] (Emphasis added).

This Court has previously approved the application of the Arkansas three year implied liability limitation period to an action to enforce a bank stockholder's assessment liability created by federal statute. **Rawlings, Receiver v. Ray**, 312 U. S. 96 (1941).

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[7] This action could probably have been maintained against all but the Bank in South Dakota. Oklahoma and Texas where a different limitations period would have no doubt been applied.

It is this same limitation period which the Supreme Court of Arkansas applies to fraud, Ark. Stats., Section 37-206 (Repl. 1962), Pope's Digest (1937), Section 8928; **White v. McBride**, supra, and to actions implied from violations of federal statutes, as here. It is clearly the most appropriate statute available, and would best effectuate the federal policy announced in the broad anti-fraud provisions of the federal securities acts. The 6th Circuit Court of Appeals in **Charney v. Thomas**, supra, squarely rejected an identical Michigan Blue Sky Law limitation of action provision having the same language as that of the Arkansas Act. The 8th Circuit Court of Appeals' own characterization of a Rule 10 b-5 action as an implied civil remedy in tort should lead to the placement of this action within at least the three-year limitation period category—its appropriate place in the Arkansas scheme or pattern of limitations of actions.

CONCLUSION

The holding of the Court of Appeals for the Eighth Circuit as to the applicable period of limitations stands in conflict with the decisions of the Courts of Appeal for the 1st, 2d, 3d, 6th, 7th, 9th and 10th Circuits, and contrary to the only decisions on point in the 4th and 5th Circuit areas, which were rendered by U. S. District Courts.

Courts of Appeal and District Courts have now explored this issue in depth. There yet exists conflict, arising from the decision now presented to this Court. It is now appropriate for this Supreme Court to resolve the conflict created by the 8th Circuit here, a conflict which is already creating confusion and consternation in other pending 10 b-5 cases about the country on an issue all previously thought settled.

The numerous cases cited from nine of the ten judicial circuits gave almost conclusive guidance to prospective litigants and their counsel that a settled policy on the limitations issue might indeed bring repose to the citizens. But the holding of the District Court below, affirmed by the Court of Appeals for the 8th Circuit, in direct conflict with the law existing in nine other judicial circuits, again unsettles the issue and permits the waste of endless argument to raise its ugly head.

The requirement of privity between the person defrauded and the person committing the securities fraud is contrary to the decisions of the Courts of Appeal for the 2nd, 5th, 6th, 7th and 9th Circuits, and contrary to District Court opinions in the 3rd and 10th Circuits. Law exists on the standing to sue—privity issue in eight of the ten circuits. Justice for these petitioners, and others similarly situated about the country, cries for a resolution now of the conflicting issues presented here. The issues are ripe for final resolution by this Supreme Court.

Respectfully submitted

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APPENDIX "A"

No. 19,682 and 19,684

United States Court of Appeals
for the Eighth Circuit

(Caption Omitted)

Decided February 24, 1970

Before: Mehaffy, Gibson and Heaney, Circuit Judges

These are appeals from a summary judgment verdict rendered in the United States District Court for the Western District of Arkansas against plaintiffs-appellants Vanderboom, et al. The complaint in the District Court stated two causes of action, one for common law fraud and deceit under Arkansas law, jurisdiction assertedly resting on diversity of citizenship, and the other a federal cause of action for violations of the securities laws, essentially 15 U. S. C., § 78(j), which is § 10 of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

The District Court ruled on December 5, 1968 that the common law fraud complaint was not cognizable because of lack of complete diversity between the parties and that this was not a proper case for the utilization of the federal courts' power of pendent jurisdiction. The federal cause of action was dismissed on summary judgment on January 24, 1969 on the ground that it was barred by the applicable state statute of limitations.[1] It is from these two rulings that these appeals are taken.

An extended discussion of the factual context of this case can be found in *City National Bank v. Vanderboom*, ... F. 2d No. 19550-4 decided the 20th day of February,

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[1] The opinion of the Hon. John E. Miller, Senior District Judge is reported in 294 F. Supp. 1178.

1970, and thus we will set forth only those facts essential to an adequate explication of this case.

The South Dakota investors (being all of the investors except Investors Thrift Corporation), and Investors Thrift Corporation (ITC), an Arkansas corporation, filed this action against Sam Sexton, Jr., an attorney, Jim Hall, former vice-president of the City National Bank of Fort Smith, Arkansas, and Huey Smith as sellers of the stock in American Home Builders, Inc. (AHB). Also included in their complaint as defendants were Austin Gatlin, a former owner of Peoples Loan and Investment Company (PL&I), Gatlin's wife, the Diamond G Ranch, Inc., a Gatlin owned corporation, and Texas Capital Corporation, formerly the principal creditor of AHB. The complaint alleged that all of the above defendants aided, abetted and conspired to defraud the South Dakota investors and ITC in connection with their purchase of the AHB stock for a total consideration of $947,300.00.[2]

Maurice Markham, president of ITC, signed an option agreement under date of September 9, 1965, providing for the purchase by appellant ITC of the capital stock of AHB which owned the controlling stock interest (68%) of PL&I. One hundred fifty thousand dollars was paid at the signing of this option, $157,500.00 at the date the option was exercised on November 2, 1965, and additional payments of $400,000.00 and $300,000.0 were made later to Texas Capital Corporation, a creditor of AHB.

All of the South Dakota appellants owned significant amounts of non-voting stock in ITC, but they did not own

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[2] Sam Sexton, Jr., has filed a counterclaim against the plaintiffs alleging a conspiracy to libel and slander him and to engage in malicious prosecution and abuse of process, seeking judgment of $1,000,000.00 actual and $1,000,000.00 punitive damages. The plaintiffs' motion to dismiss Sexton's counterclaim has not yet been acted upon by the District Court and is still pending.

all of the capital stock of ITC. They dispute whether Markham should be considered as their agent at the time of the option agreement, but we think this contention is clearly without merit.[3] The option was to extend until January 10, 1966, but was exercised on November 2, 1965, and all payments were made and all stock delivered by January 10, 1966. The complaint in this case was filed July 18, 1968.

STATUTE OF LIMITATIONS

Section 10 of the Securities and Exchange Act of 1934 contains no statute of limitations. As a result there is some question as to the applicable statute of limitations for the federally created cause of action.

The cases of *United Automobile Workers v. Hoosier Cardinal Corp.*, 383 U. S. 696 (1966), *Cope v. Anderson, Receiver*, 331 U. S. 461 (1947), and *Holmberg v. Armbrecht*, 327 U. S. 392 (1946), as well as a legion of lower court cases, make it clear that when the federal legislative act is silent as to the statute of limitations applicable to it, the limitations period of the forum state is applied. But it is not entirely clear which of several Arkansas statutes of limitations is the appropriate one to apply. The basic standard for determining which of the various local periods of limitation to utilize is that it should be "one which best effectuates the federal policy at issue." *Charney v. Thomas*, 372 F. 2d 97, 100 (6th Cir. 1967).

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[3] The evidence is clear that Markham was the agent for the South Dakota investors at the time the option agreement was signed and at the time the purchase was concluded on January 10, 1966. This would make Markham the agent for the South Dakota investors when he personally took charge of AHB and PL&I on September 9, 1965. The District Court so found in its opinion in *City National Bank v. Vanderboom*, 290 F. Supp. 592, 609 (1968). Whether Markham continued to act as agent for the South Dakota investors after the option purchase was consummated cannot be determined from this record. This is a matter that can only be determined by a trial upon remand of this case.

Appellants contend that the proper statute of limitations to follow is found in Ark. Stat. Ann., § 37-206 (Replacement 1962), a general statute of limitations applying to any action of account, assumpsit or on the case, founded on any contract or liability, and which, according to the District Court, has been made applicable to common law fraud and deceit by Arkansas judicial decision. *See: Air Leases v. Baker*; 167 F. Supp. 145 (W. D. Arkansas, 1958). Under this statute an action must be brought within three years of the date it accrues. If this statute were applicable, appellants would not be barred by the statute of limitations. Appellants admit that the Arkansas five year general catch-all statute of limitations does not apply to the action set forth in the complaint.

The appellees contend, and the District Court determined, that the appropriate statute of limitations for the federally based 10b-5 action[4] is found in § 22 of the Arkansas Securities Act of 1959, Ark. Stat. Ann., § 67-1256 (e), (Replacement 1966), which is also § 410(e) of the Uniform Securities Act. There it is stated that no person suing under that statute may do so more than two years after the relevant contract of sale. We agree with the District Court that this is the proper statute of limitations to apply since it deals expressly with the sale of securities.

While appellants contend that no federal case has applied a short blue-sky statute of limitations, it appears that this ordinarily would be the most reasonable and logical type of statute to apply to essentially what might be termed an "implied federal blue-sky" type of statutory action. See: A. Bromberg, Securities Law, Fraud, SEC Rule 10b-5. The reported federal courts of appeals cases

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[4] We assume as held in *Air Leases v. Baker, supra*, that the Arkansas three year statute of limitations would be applicable to the common law segment of this tort action, but this issue was not reached in the District Court as that action was dismissed for lack of complete diversity.

on this issue favorable to appellants' position include *Charney v. Thomas*, 372 F. 2d 97 (6th Cir. 1967), which refused to apply the Michigan blue-sky statute of limitations because the Michigan blue-sky law did not contain any provision similar to rule 10b-5, and instead applied the longer Michigan statute of limitations on general common law fraud; *Janigan v. Taylor*, 344 F. 2d 781 (1st Cir. 1965), *cert. denied*, 382 U. S. 879 (1965), which applied a Massachusetts two year statute, with no discussion of other possible statute; *Errion v. Connell*, 236 F. 2d 447 (9th Cir. 1956), which applied the Washington three year fraud statute from the date of the discovery of the fraud without discussing any other possible blue-sky type of statute; and *Fratt v. Robinson*, 203 F. 2d 627 (9th Cir. 1953), which applied the Washington fraud statute of three years instead of a two year statute covering liability created by statute.

Since the standard for determining the applicable statute of limitations is to select the statute that best effectuates the federal policy involved, it is appropriate to look to the local statute which bears the closest resemblance to the federal statute involved. Rule 10b-5 states:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud.
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud

or deceit upon any person, in connection with the purchase or sale of any security."

It is suggested by the appellants that there is no section of Ark. Stat. Ann., § 67-1235-1262 (Replacement 1966) (the Arkansas blue-sky provision) which is entirely comparable to Rule 10b-5. It is true that though Rule 10b-5 is codified as § 101 of the Uniform Securities Act and as § 67-1235 of the Arkansas blue-sky law, it was specifically stated in the Commissioner's notes to this section that it was to create no private remedy. The only section of the Act which provides a private remedy is § 410, Ark. Stat. Ann., § 67-1256 (Replacement 1966). This section is modeled after and parallels Section 12(2) of the Securities Act of 1933, 15 U. S. C., § 77(b). Section 67-1256 states in relevant part:

> "Any person who—
>
> (2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable to the person purchasing such security from him. . . ."

It is evident that Rule 10b-5 and § 67-1256 of the Arkansas blue-sky statute are not identical. The latter specifically creates the defense of lack of knowledge, or ability to know the untruth of representations made by the de-

fendant, whereas Rule 10b-5 on its face creates no defenses. In the case of *Trussell v. United Underwriters Ltd.*, 228 F. Supp. 757 (D. Col. 1964) the Court, following a controlling 10th Circuit opinion, *Rice v. United States*, 149 F. 2d 601 (10th Cir. 1945), construed Rule 10b-5 to require scienter and to be basically analogous to common law fraud. Under such a construction it was perhaps correct to use the local statute of limitations which specifically applied to common law fraud, rather than the statute of limitations pertaining to the local blue-sky law in which the private remedy was comparable to § 12 (2) of the Securities Act of 1933 which provides recovery for negligent as well as knowing and intentional misrepresentations. Similarly, in *Charney v. Thomas, supra*, the Court held that the local blue sky private remedy (also taken from § 410 of the Uniform Securities Act and based upon § 12 (2) of the Securities Act of 1933) was comparable to § 12 (2) and not to Rule 10b-5 and thus applied the state statute of limitations applicable to fraud. However, the present rule in the 8th Circuit is that Rule 10b-5 applies to negligent as well as intentional misrepresentations. *Myzel v. Fields*, 386 F. 2d 718, 734-35 (8th Cir. 1967), *cert. denied* 390 U. S. 951 (1968). We therefore view the appellants' federal claims as a blue-sky type of implied statutory action rather than as a basic fraud action.

This Court has said that "[p]roof of 'scienter' i. e., knowledge of the falseness of the impression produced by the statements or omissions made, is not required under Section 10 (b) of the Act." *Myzel v. Fields*, 386 F. 2d 718, 734-35 (8th Cir. 1967), *cert. denied* 390 U. S. 951 (1968). This ruling is further supported in the landmark case of *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, 855 (2d Cir. 1968), a suit seeking injunctive relief, where the Court said:

"Absent any clear indication of a legislative intention to require a showing of specific fraudulent intent,

> the securities laws should be interpreted as an expansion of the common law both to effectuate the broad remedial design of Congress, and to insure uniformity of enforcement. Moreover, a review of other sections of the Act from which Rule 10b-5 seems to have been drawn suggests that the implementation of a standard of conduct that encompasses negligence as well as active fraud comports with the administrative and the legislative purposes underlying the Rule." [Citations omitted].

It might be said that neither *Myzel v. Fields, supra,* nor *Texas Gulf Sulphur, supra,* involves private relief sought by a buyer, *Myzel* involving a seller, and *Texas Gulf Sulphur* being a suit by the SEC. In cases under Rule 10b-5 in which a buyer has sought relief it has been suggested by some courts that a mere negligent misrepresentation is not sufficient to ground relief, on the theory that to allow such recovery is to nullify the strict procedural requirements found in § 12 (2) which is strictly a buyer's remedy. *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951). No procedural requirements are found in § 10 (b). In *Ellis v. Carter*, 291 F. 2d 270 (9th Cir. 1961) this problem was presented and the Court there said that to restrict buyer's relief under Rule 10b-5 to cases of intentional misrepresentations would be to discriminate in favor of sellers, who would not be so limited, and against buyers. Since no such discriminatory intention is evident on the face of § 10 (b) or from its legislative history, and since § 10 (b) was written in 1934, one year after § 12 (2), the Court held that buyers suing under Rule 10b-5 could recover for negligent misrepresentations. We believe this is the correct approach, and calls for a shorter limitations period on the federal claim.

On the other hand, the District Court found that under Arkansas law one can recover for common law fraud and deceit only if scienter or international misrepresentation

is proved. The Court cited a long list of cases including *Sledge & Norfleet Co. v. Mann*, 103 S. W. 2d 630 (1937) and *Croley v. Baker*, 371 S. W. 2d 830 (1963). There are a few cases in Arkansas suggesting that recovery can be had for negligent misrepresentations under a theory of "constructive fraud". *Lane v. Ruchtl*, 389 S. W. 2d 621 (1965); *Stewart v. Clark*, 115 S. W. 2d 887 (1938). These cases, however, only constitute an exception to the general rule in Arkansas requiring scienter and the exception is applied to those situations where certain acts without scienter constitute constructive fraud as a matter of public policy. Thus, there is a clear distinction between actions proceeding under federal Rule 10b-5 and actions proceeding under the Arkansas law of fraud in that the former is much more favorable to plaintiffs, eliminating several of the defenses available to defendants in a common law fraud action.

In short, common law fraud in Arkansas apparently requires scienter (calling for the 3 year statute of limitations), whereas misrepresentations under Arkansas blue-sky law are actionable if either intentionally or negligently made. In the 8th Circuit Rule 10b-5 applies to intentional and negligent misrepresentations, and like the Arkansas blue-sky law is specifically aimed at securities fraud. In light of the commonality of purpose and the lack of defenses available under both Rule 10b-5 and the Arkansas blue-sky law as compared with common law fraud in Arkansas, we agree with the District Court that the 2 year statute of limitations found in § 22 of the Arkansas Securities Act of 1959 is the appropriate one to apply.

The appellants alternatively argue that even if the two year statute of limitations is applied it should not necessarily be deemed to run from the date of the fraudulent or actionable contract of sale as required under § 22 of the Arkansas Securities Act. The appellants admit that if

§ 22 is followed in its entirety including the provision regarding the time when the statute begins to run, then regardless of when the fraud took place within the period of September 1965 to January 1966, the statute would have run and their action would have been barred when filed in July, 1968.

Holmberg v. Armbrecht, 327 U. S. 392 (1946) held that where the cause of action is federal in origin but a forum state's statute of limitations is being used, and the action is equitable in nature, federal law applies in regard to determining the date on which a statute of limitations begins to run. Federal law since the case of *Bailey v. Glover*, 88 U. S. 342 (1875) has been that in cases involving elements of fraud neither a statute of limitations nor the equitable doctrine of laches can be said to begin to run until the fraud is or should have been discovered. The doctrine that federal law applies in determining the date on which a statute of limitations begins to run was extended in *Moviecolor Limited v. Eastman Kodak Company*, 288 F. 2d 80 (2d Cir. 1961) (dictum), *cert. denied* 368 U. S. 821 (1961) to include cases at law as well as equity if the cause of action is federal in nature and even though a state statute of limitations applies.

It is true that a 10b-5 claim is a legal action based upon an implied civil remedy in tort, *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951), and even though the distinction between law and equity must be preserved in federal courts under Art. III, § 2 clause 1 of the United States Constitution,[5] still there is no reason to differentiate as between the two kinds of actions, in applying the federal policy as to the determining date on which a statute of limitations or laches begins to run. We feel that the remedial policy expressed by Congress in enacting the

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[5] See 32 Am. Jur. 2nd *Federal Practice and Procedure*, § 20 (1967) and cases noted therein.

securities legislation would best be served by making any statute of limitations run only from the date of the discovery of the fraud or from the date the fraud upon reasonable inquiry should have been discovered.

This decisional rule was specifically applied in a Rule 10b-5 case in *Janigan v. Taylor*, 344 F. 2d 781 (1st Cir. 1965), *cert. denied*, 382 U. S. 879 (1965). There the court held that although a two year state statute of limitations was applicable to the federal 10b-5 action, nevertheless federal law applied to determine the date the statute began to run, and the Court held that under federal law statutes of limitations do not begin to run in cases involving elements of fraud, until the fraud is, or should be, discovered. The case of *Turner v. Lundquist*, 377 F. 2d 44 (9th Cir. 1967), cited by appellees, is distinguishable. There the court did look to the California law in determining the date on which the statute began to run, but just as under federal law, and unlike the situation in *Janigan v. Taylor*, *supra*, California law required discovery of the fraud in cases involving elements of fraud before a statute of limitations began to run.

Regardless of whether the alleged misrepresentation took place as early as September 1965 or as late as January 1966, the record before us is not clear as to when the alleged fraud, with due diligence on the part of the investors, should have been discovered.[6] The appellants

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[6] The investors alleged in their complaint that certain representations as to the value of AHB and its related companies were made by Sexton and by Hall. Sexton admitted that he stated the value to be $340,000.00 to $350,000.00 and Hall is alleged to have represented the value at $1,000,000.00. These representations, of course, are subject to further proof and evaluation. The investors, after all, only paid to the sellers $207,500.00 for the sellers' stock, the rest being paid to Texas Capital on company obligations, and to Markham and Gatlin.

Investors, however, claim that they did not discover the alleged fraud until Fred Landau & Company had completed an audit of

contend that the complicated internal structure of the corporations along with the extremely high level of separate individual accounts (representing mostly mortgage loans) held by AHB, in comparison with its total capital position, rendered an accurate and early accounting impossible. The appellees counter that the company's entire financial situation was available to the investors during the option period, and if the company was in financial difficulties, this should have been discovered at that time. Furthermore, the appellees assert that the appellants' own evidence shows that the alleged fraud was known by them at earlier dates in this unfortunate business transaction. This again is a matter that can only be determined upon a plenary trial.

Summary judgment under the Federal Rules of Civil Procedure, Rule 56, is to be used only in cases where there is no genuine issue as to any material fact. *Chambers v. United States*, 357 F. 2d 224 (8th Cir. 1966). Here we have a disputed unresolved issue of fact, namely, by what date was the alleged fraud discovered or should it have been discovered. It is not possible to determine whether the statute of limitations is a bar to this action until this issue is decided. Thus, we remand this question to the District Court for trial.

Appellants also contend that the statute of limitations was tolled by the filing of the suit in South Dakota in

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AHB and PL&I in November of 1967. That audit allegedly shows the net worth of AHB as of September 1965 to be a minus $537,253.18 and PL&I as of June 30, 1965 as $31,152.41. This, of course, presents several major unresolved issues upon which the merits of the case would turn. See companion case of *City National Bank v. Vanderboom*, No. 19550-4 decided the 20th day of February, 1970.

In other words, whether any actionable representations of actual value were made by the sellers and the accuracy of the Fred Landau audit of November 1965 can only be determined upon a trial of the issues in this case and not upon summary judgment.

November, 1967. This point is not well taken as many of the appellants were not included as parties in the South Dakota case. Furthermore, as we shall point out below, the only proper party plaintiff in the present suit is ITC and since it was not included in the South Dakota suit it cannot claim that that suit, involving a different array of parties plaintiff, tolled the statute of limitations for purposes of this case. It appears obvious that since ITC was not a party to the South Dakota action, it could not claim any benefits that might accrue relative to that suit. *See* 54 C. J. S. *Limitations of Actions*, § 278 (1948).

PENDENT JURISDICTION ISSUE

Appellants next assert that the District Court erred in dismissing appellants' common law fraud claim. Issue is not taken with the District Court's determination that due to the presence of ITC (an Arkansas corporation) in the lawsuit, complete diversity between the parties was lacking. However, appellants claim the common law action should have been heard under the doctrine of pendent jurisdiction. In *United Mine Workers v. Gibbs*, 383 U. S. 715 (1966) the Supreme Court discussed the doctrine of pendent jurisdiction at page 722:

> "The court held in *Hurn v. Oursler*, 289 U. S. 238, that state law claims are appropriate for federal court determination if they form a separate but parallel ground for relief also sought in a substantial claim based on federal law. The Court distinguished permissible from nonpermissible exercises of federal judicial power over state law claims by contrasting 'a case where two distinct grounds in support of a single cause of action are alleged, one only of which presents a federal question, and a case where two separate and distinct causes of action are alleged, one only of which is federal in character. In the former, where the fed-

> eral question averred is not plainly wanting in substance, the federal court, even though the federal ground be not established, may nevertheless retain and dispose of the case upon the non-federal *ground;* in the latter it may not do so upon the non-federal *cause of action.*' "

As in *United Mine Workers v. Gibbs, supra*, the question here is, into which of the two categories suggested does this common law claim fall. The District Court stated its opinion was "that two separate causes of action are alleged, only one of which is federal in character. The other is based upon the common law." 294 F. Supp. at 1183. Thus the District Court dismissed the common law claim. But the Supreme Court in *United Mine Workers v. Gibbs, supra*, took a much less restrictive view of what constitutes a cause of action, and concomitantly took a more expansive view of federal court power under the doctrine of pendent jurisdiction, stating at 725:

> "Pendent jurisdiction, in the sense of judicial *power*, exists whenever there is a claim 'arising under [the] Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority . . .' U. S. Const. Art. III, § 2, and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional 'case.' The federal claim must have substance sufficient to confer subject matter jurisdiction on the court. The state and federal claims must derive from a common nucleus of operative fact. But if, considered without regard to their federal or state character, a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial proceeding, then, assuming substantiality of the federal issues, there is *power* in federal courts to hear the whole" [Citations omitted].

We feel, therefore, that the present law suit unquestionably comprises one cause of action supported by several alternate theories of recovery. Thus, the District Court was not without power to adjudicate the common law claim.

The appellees correctly point out, however, that the use of this power is discretionary. *United Mine Workers v. Gibbs, supra*, at 726. Appellees cite several cases in which courts stated the state law claim should be dismissed if the federal claim was itself dismissed before trial. *United Mine Workers v. Gibbs, supra*, at 726, and *Wham-O-Mfg. Co. v. Paradise Manufacturing Co.*, 327 F. 2d 748 (9th Cir. 1964). However, that is no longer the posture of this case since the District Court must determine anew whether the two year statute of limitations stands as a bar to the federal cause of action. Thus, in remanding this case we reinstate the common law fraud action, believing that if the federal cause of action reaches the merits, judicial economy and convenience would favor the use of the power of pendent jurisdiction and the simultaneous determination of the common law and the federal claims. We respect, however, the trial court's discretion in considering the pendent jurisdiction issue.

STANDING TO SUE QUESTION

Finally, we must consider the question of whether all of the parties plaintiff have standing to sue in this action on the 10b-5 claim. Appellees point out that only ITC was a party to the agreement of September 9, 1965, and thus only ITC was a purchaser under Rule 10b-5. *Surowitz v. Hilton Hotels Corporation*, 342 F. 2d 569 (7th Cir. 1965), *rev'd on other grounds*, 383 U. S. 363 (1966), held at 604:

> "Where it has appeared that a corporation was the party injured by a violation of Section 10 (b) of the

1934 Act, the courts have held that a shareholder of that corporation has standing to sue only on a derivative basis."

The investors have never indicated they were bringing this case as a derivative suit. The cases cited by appellants are inapposite since in all of them the corporation was clearly a sham, unlike ITC which was originally set up as an investment corporation and only later became a holding corporation for the investors. Here we have no basis for disregarding the corporate integrity. *See*: companion case of *City National Bank v. Vanderboom*, Nos. 19550-4 decided the 20th day of February, 1970.

As noted in *Greater Iowa Corporation v. McLendon*, 378 F. 2d 783, 790 (8th Cir. 1967) "A breach of statutory duty does not give rise to a private cause of action to every person injured by the statutory breach. The law clearly demands that the statutory breach must cause injury to one of the class that the statute is designed to protect."

The Securities Act was designed primarily to protect investors by "promoting full disclosure of information thought necessary to informed investment decisions." *SEC v. Ralston Purina Co.*, 346 U. S. 119, 124 (1953). If any recovery is had in this case because of fraudulent concealment of material facts or misrepresentation in the sale of the securities, the right of action runs to the purchaser, ITC, of which the South Dakota appellants constitute only one class of stockholders, owning only non-voting stock. The voting stock of ITC was owned by Markham who is not a party in this suit and who was in active control of the corporations purchased by ITC from September 9, 1965 until their financial demise. Thus, we feel that ITC is the only proper party plaintiff on the 10b-5 claim.

We, therefore, remand this case to the District Court with instructions to determine at trial when the alleged fraud was discovered or should have been discovered in order to decide whether the two year Arkansas blue-sky statute of limitations is a bar to the 10b-5 claim, and we reinstitute the Arkansas common law fraud claim, at least until such time as the District Court determines whether the statute of limitations stands as a bar to the 10b-5 claim. Nor do we mean to imply that the common law fraud claim should be dismissed even if the statute of limitations has run on the 10b-5 claim as the District Court would still have the discretion to consider the common law fraud claim in view of the fact that there is undeniable federal jurisdiction on the 10b-5 claim. We recognize the admonition of *United Mine Workers v. Gibbs, supra*, at 726 that if federal claims are dismissed before trial, the state claims should also be dismissed. But, since a full hearing is required in this case to determine the issue of whether the statute of limitations has run on the 10b-5 claim, it would probably serve the best interest of justice and also the time and expense of litigants to determine all claims, federal and non-federal in one hearing.

Reversed and remanded for proceedings consistent with this opinion.

APPENDIX "B"

United States Court of Appeals
for the Eighth Circuit

Nos. 19,682 and 19,684

(Caption Omitted)

These causes came on to be heard on the record from the United States District Court for the Western District of Arkansas and were argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that the orders of the said District Court appealed from in these causes be, and they are hereby, reversed.

And it is further ordered by this Court that these causes be, and they are hereby, remanded to the said District Court for proceedings consistent with the opinion of this Court this day filed herein.

February 24, 1970.

APPENDIX "C"

No. FS-68-C-47

United States District Court
Western District of Arkansas
Fort Smith Division

(Caption Omitted)

Decided January 24, 1969

Before: John E. Miller, United States Senior District Judge

Opinion

The questions before the court arise on the motions of the defendants for summary judgment.

On December 16, 1968, the defendant, Sam Sexton, Jr., filed his motion for summary judgment in accordance with the provisions of Rule 56(b)(c), Fed. R. Civ. P., on the ground that "the complaint, answer of this defendant, and affidavit of this defendant attached hereto and marked Exhibit A, show that the defendant is entitled to judgment as a matter of law."

On December 20, 1968, the defendants, Austin Gatlin, Erma S. Gatlin and Diamond G Ranch, Inc., filed their motion for summary judgment containing substantially the same allegations as made by the defendant Sexton.

On December 20, 1968, the defendant, TeleCom Corporation (Texas Capital Corporation), filed its motion under Rule 56 on the ground "that the complaint, answer and all other pleadings of the defendants herein and the affidavit and exhibits of the defendants herein which are

incorporated by reference show that the defendant is entitled to judgment as a matter of law."

On December 23, 1968, the defendant, James S. Hall, filed his motion for summary judgment to dismiss the action "on the ground that there is no genuine issue as to any material fact and that this defendant is entitled to a judgment as a matter of law.

"This motion is based upon:

1. The pleadings in the within case;

2. The affidavit of James S. Hall, to which copies of the following documents are attached as Exhibits A and B, respectively:

a. The contract of sale executed on September 9, 1965, among defendants Sexton, Hall and Smith as sellers and plaintiff Investors Thrift Corporation as buyer;

b. The assignment of stock powers by Sexton, Hall and Smith to plaintiff Investors Thrift Corporation that was accomplished on November 2, 1965, pursuant to the contract of sale of September 9, 1965."

Rule 56(b), Fed. R. Civ. P., provides:

"A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof."

Subparagraph (c), as amended January 21, 1963, effective July 1, 1963, provides:

"The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing

affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages."

Before discussing the issues and contentions of the parties, the court is of the opinion that the present status of the case and a brief resume of the pleadings should be set forth.

On July 18, 1968, plaintiffs commenced this action by filing their complaint containing 32 numbered paragraphs and 13 pages. The complaint contains only one count, but an analysis of the various paragraphs discloses that there are two causes of action stated. In paragraphs 14, 15, 16, 21, 22, 24, 25, 26, 27, 28 and 30 the plaintiffs state a common-law action for fraud and deceit. In paragraphs 17, 18, 19, 20, 21, 23, 24, 29 and 30 the plaintiffs attempt to state a federal cause of action.

In paragraph 29 the plaintiffs alleged:

"By their acts, the defendants, jointly and severally, combined in an unlawful conspiracy and employed a manipulative and deceptive device with respect to the sale of stock of American Home Builders, Inc., to the plaintiffs, which operated as a fraud and deceit upon the plaintiffs.

"By their acts, therefore, Sexton, Hall, Smith and Austin Gatlin combined in an unlawful conspiracy, and were aided and abetted by The City National Bank, Texas Capital Corporation [TeleCom Corp.],

Diamond G Ranch, Inc., and Erma S. Gatlin in employing a manipulative device and a scheme and artifice to defraud the plaintiffs, and did thereby damage the plaintiffs in violation of their rights and in violation of 15 U. S. C. 77l [§ 12 of the Securities Act of 1933], 15 U. S. C. 77q [§ 17 of the Securities Act of 1933], 15 U. S. C. 78j [§ 10 of the Securities Act of 1934], and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, and 6 Ark. Stat. App. 67-1256 (Repl. Vol. 1966)."

All the defendants except Charles H. Smith, who is in Vietnam and has not been served with process, and the City National Bank of Fort Smith filed answers, denying the allegations of the complaint, and in the amendments to their answers pleaded that "the alleged causes of action as reflected by plaintiffs' complaint are barred by limitations as they were not commenced within the period of time as allowed by the statutes of the State of Arkansas and the United States Code."

On August 1, 1968, the City National Bank filed its separate motion to dismiss the complaint and or motion for summary judgment. On August 8, 1968, the court, upon consideration of the motion, dismissed the complaint of Investors Thrift Corporation for failure to state a claim against the movant, City National Bank, and granted the motion for summary judgment against all the other plaintiffs except abated the action of the plaintiff R. S. Miskimins until the disposition of a similar suit pending in the Sebastian Circuit Court, No. 5695.

On the date the order was entered, the plaintiffs, late in the afternoon, filed their response to the motion of the City National Bank, whereupon the court on August 12, 1968, reviewed its consideration of the motion, as well as the pleadings in Civil Actions Nos. 2103-2107, and re-

examined its order of August 8, 1968, and reaffirmed the same.

On August 15, 1968, plaintiffs filed their notice of appeal from the order.

Later, on October 17, 1968, the court entered an order dismissing the complaint of plaintiff R. S. Miskimins.

On December 5, 1968, the court, sua sponte, considered whether it had jurisdiction of the common-law cause of action alleged in plaintiffs' complaint and heretofore referred to, and as a result of the investigation the court entered an order dismissing for lack of jurisdiction portions of the complaint which alleged a cause of action against the defendants under the common law.

The complaint discloses that all the plaintiffs except Investors Thrift Corporation are citizens and residents of the State of South Dakota, but that Investors Thrift Corporation was organized under the laws of the State of Arkansas and maintains its principal place of business in the Western District of Arkansas. All of the defendants are citizens of Arkansas except Texas Capital Corporation which was organized under the laws of the State of Texas with its principal office at Georgetown, Texas. Thus, there is no diversity of citizenship between all of the plaintiffs and all of the defendants. Title 28, U. S. C. A. 1332(a)(1).

To sustain jurisdiction on grounds of diversity of citizenship, there must exist an actual, substantial controversy between citizens of different states, all of whom on one side of the controversy are citizens of different states from all parties on the other side. Rock Island Millwork Co. v. Hedges-Gough Lumber Co. (8 Cir. 1964), 337 F. 2d 24. The court cannot, therefore, consider the plaintiffs' allegations of common-law fraud. However, if the jurisdic-

tional requirements of 28 U. S. C. A. 1332(a)(1) were satisfied, there would be no reason why plaintiffs could not join their common-law claim with their claims under federal statutes. The rule of "pendant jurisdiction" stated broadly is that once jurisdiction is properly assumed under federal law, the jurisdiction extends to the determination of all questions in the cause, including questions of state law, irrespective of the disposition made of the federal questions. The Supreme Court in Hurn v. Oursler (1933), 289 U. S. 238, 53 S. Ct. 586, L. Ed. 1148, at page 589 of 53 S. Ct., stated:

> "But the rule does not go so far as to permit a federal court to assume jurisdiction of a separate and distinct nonfederal cause of action because it is joined in the same complaint with a federal cause of action. The distinction to be observed is between a case where two distinct grounds in support of a single cause of action are alleged, one only of which presents a federal question, and a case where two separate and distinct causes of action are alleged, one only of which is federal in character. In the former, where the federal question averred is not plainly wanting in substance, the federal court, even though the federal ground be not established, may nevertheless retain and dispose of the case upon the nonfederal **ground**; in the latter it may not do so upon the nonfederal **cause of action.**"

At page 590 of 53 S. Ct. the court said:

> "The bill as amended, although badly drawn, sets forth facts alleged to be in violation of two distinct rights, namely, the right to the protection of the copyrighted play, and the right to the protection of the uncopyrighted play. From these averments two separate and distinct causes of action resulted, one arising under a law of the United States, and the other aris-

> ing under general law. For reasons that have already been made manifest, the latter is entirely outside the federal jurisdiction and subject to dismissal at any stage of the case. It is hardly necessary to say that a federal court is without the judicial power to entertain a cause of action not within its jurisdiction, merely because that cause of action has mistakenly been joined in the complaint with another which is within its jurisdiction."

See, also, Wright, Federal Courts, § 19. The court is of the opinion that two separate causes of action are alleged, only one of which is federal in character. The other is based upon the common law.

In Moran v. Paine, Webber, Jackson & Curtis (W. D. Pa. 1966), 279 F. Supp. 573, the court at page 577 said:

> "We recognize that actions under both the Securities Act of 1933 and the Securities Exchange Act of 1934 are based on different elements from common-law actions for fraud and deceit in state courts, and that the same set of operative facts may give rise to separate causes of action."

In affirming the judgment of the District Court, the Third Circuit at page 245 of 389 F. 2d said:

> "Accordingly, after a careful scrutiny of the record we affirm the findings of the lower court that the defense of res judicata was there well pleaded as to appellant's cause of action arising out of its common-law rights cognizable under diversity jurisdiction and as to those rights claimed under the Securities Act of 1933 cognizable under the court's concurrent jurisdiction."

In § 78, p. 297, Wright on Federal Courts, the learned author states:

"Where the basis of jurisdiction is a federal claim, however, plaintiff may not join with it a separate and distinct non-federal claim unless diversity exists."

In Guthrie v. United States (E. D. Wisc. 1965), 238 F. Supp. 855, the court, in discussing the question under consideration, said at page 856:

"Joinder of the distinct, non-federal claim based on contract with the federal claim against the government; if permitted, cf. Lloyds' London v. Blair, 262 F. 2d 211, 213 (10th Cir. 1958), must rest on independent jurisdictional grounds. Delman v. Federal Products Corporation, 251 F. 2d 123, 125 (1st Cir. 1958). The doctrine of pendent jurisdiction has no application where there are separate causes of action rather than distinct grounds for relief in support of a single cause of action. Hurn v. Oursler, 289 U. S. 238, 246, 53 S. Ct. 586, 77 L. Ed. 1148 (1933). And see Wright, Federal Courts, § 19, pp. 55-57, and § 78, p. 297.".

In Delman v. Federal Products Corporation (1 Cir. 1958), 251 F. 2d 123, the court at page 126, said:

"The plaintiff's cause of action for breach by the defendant of its contract to employ the plaintiff, if indeed such a cause of action is alleged, is certainly not one arising under the Constitution, laws or treaties of the United States but is one arising under state law. Federal jurisdiction over it must, therefore, rest upon the diversity jurisdiction conferred by § 1332 (a)(1) of Title 28 of the United States Code. But jurisdiction under this section fails, for not only is there no allegation that the required jurisdictional amount is in controversy, but also it is apparent that the plaintiff and for jurisdictional purposes the defendant also are both citizens of Rhode Island. Nor

> is there pendent jurisdiction over the cause of action for breach of the contract of employment under the doctrine of Hurn v. Oursler, 1933, 289 U. S. 238, 53 S. Ct. 586, 71 L. Ed. 1148, for that cause of action is not at all the same as the plaintiff's cause of action for failure to grant reemployment as the acts of Congress require, and under Hurn v. Oursler (289 U. S. at page 246, 53 S. Ct. at page 589), pendent federal jurisdiction exists only when 'two distinct grounds in support of a single cause of action are alleged, one only of which presents a federal question,' and does not exist when 'two separate and distinct causes of action are alleged, one only of which is federal in character.'"

See, also, Sunbeam Lighting Co. v. Pacific Asso. Lighting, Inc. (9 Cir. 1964), 328 F. 2d 300: Murphy v. Kodz (9 Cir. 1965), 351 F. 2d 163: WHAM-O-MFG. Co. v. Paradise Mfg. Co. (9 Cir. 1964), 327 F. 2d 748.

In 1A, Moore's Federal Practice, 2d Ed., at page 712, there appears an extensive note by the author on the subject "Co-extensiveness of Pendent Jurisdiction and § 1441 (c)," in which the author discusses Hurn v. Oursler, supra.

In Murphy v. Kodz, supra, the court discussed a great many cases on the question of pendent jurisdiction, and at page 166 stated:

> "From these cases it is clear that, absent some statutory limitation, federal jurisdiction may be exercised over non-federal facets of a case if there is first established jurisdiction based on a substantial federal ingredient."

In the instant case there is a statutory limitation of jurisdiction, and therefore the court lacks jurisdiction to consider the non-federal claim.

In addition, the claim of the individual plaintiffs is derivative and the corporation is a necessary party to the suit. In discussing this question, the Supreme Court in Price v. Gurney (1945), 324 U. S. 100, 65 S. Ct. 513, 89 L. Ed. 776, at page 516 of 65 S. Ct., said:

> "There is a misconception running through the presentation of this case which should be noted at the outset. It is a misnomer to speak of the filing of the petition on behalf of the corporation as a derivative action. A derivative action is a suit by a shareholder to enforce a corporate cause of action. The corporation is a necessary party to the suit. And the relief which is granted is a judgment against a third person in favor of the corporation. That is the rule in Ohio as well as elsewhere. 10 Ohio Juris., § 244 et seq.; Dodge v. Woolsey, supra; Davenport v. Dows, supra; Hill v. Murphy, 212 Mass. 1, 98 N. E. 781, 40 L. R. A., N. S. 1102, Ann. Cas. 1913C, 374; Groel v. United Electric Co., 70 N. J. Eq. 616, 61 A. 1061; Continental Securities Co. v. Belmont, 206 N. Y. 7, 99 N. E. 138, 51 L. R. A., N. S. 112, Ann. Cas. 1914A, 777. Similarly, if a corporation has a defense to an action against it and is not asserting it, a stockholder may intervene and defend on behalf of the corporation. 10 Ohio Juris., § 257; Eggers v. National Bank of Seneca, 62 Kan. 163, 61 P. 684, 84 Am. St. Rep. 377. Moreover, equity has evolved numerous remedies to protect not only the rights of the corporation but the interests of the stockholders as such against various acts of mismanagement. See 10 Ohio Juris., § 260 et seq.; Berle, Studies in the Law of Corporation Finance (1938). But respondents have not pursued either course. The petition which they have filed with the bankruptcy court is not a suit to enforce or protect a corporate right. Nor is it a suit to protect the interests of the respondents as stockholders. Yet if

it were either one, the federal District Court could not entertain it. No diversity of citizenship is shown, and no other basis of federal jurisdiction is apparent. The question, therefore, is whether the bankruptcy court as an incident of its bankruptcy powers can give respondents relief which, if their charges are taken as true, they might obtain in another forum. We do not think it can."

The first sentence of brief of plaintiffs submitted December 26, 1968, is as follows:

> "Plaintiffs concede that their action must rest under Rule 10b-5 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, and common law fraud (previously dismissed)."

The defendant Sexton pleaded in numbered paragraph 33 of his original answer the statute of limitations as a complete defense to the claims of the plaintiffs. Each of the other defendants was granted leave by the court to file an amendment to his or its answer to plead the statute. Such amendments were filed prior to the pleading of the statute of limitations by the motions to dismiss and or for summary judgment.

"The legal effect of the bar clearly appears from the complaint, and the defense that the claim is barred by the applicable statute of limitations may be raised by motion for summary judgment, motion to dismiss, or by motion for judgment on the pleadings. Albrecht v. Indiana Harbor Belt R. Co. (7 Cir. 1949), 178 F. 2d 577, cert. den. 339 U. S. 949, 70 S. Ct. 804, 94 L. Ed. 1363; Anderson v. Linton (7 Cir. 1949), 178 F. 2d 304; Erickson v. Woodrough (8 Cir. 1947), 164 F. 2d 107, cert. den. 334 U. S. 849, 68 S. Ct. 1500, 92 L. Ed. 1772; Cool v. International Shoe Co. (8 Cir. 1944), 142 F. 2d 318; Roe v. Sears, Roebuck & Co.

(7 Cir. 1943), 132 F. 2d 829; Jones v. Bankers Life Co. (4 Cir. 1942), 131 F. 2d 989; Craig v. Western & Southern Indemnity Co. (6 Cir. 1941), 119 F. 2d 591; Adams v. Greer (W. D. Ark. 1953), 114 F. Supp. 770.

In the consideration and disposition of the motions of defendants the court must determine if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

The complaint was filed July 18, 1968, and, inter alia, it is alleged that for the purpose of purchasing the stock of the corporations, Markham, as the agent of plaintiffs, and defendants Sexton, Hall and Smith entered into an option agreement on September 9, 1965, providing for the purchase by Investors Thrift of the capital stock of American Home Builders (AHB), Peoples Loan & Investment Company (PL&I), and subsidiary corporations. In the option Sexton, Hall and Smith granted Investors Thrift an option to purchase all of the stock upon the terms and conditions set forth in the option. The investors were granted until January 10, 1966, to exercise the option. Paragraph IV provides:

> "The parties specifically agree that until January 10, 1966, or until the exercise of said option, whichever is sooner, Smith shall continue in his capacity as President of AHB, and Sexton shall continue in his capacity as Chairman of the Board and General Manager of PLI; provided that Austin Gatlin shall be and act as consultant for PLI, commencing September 15, 1965, at a monthly salary of One Thousand Five Hundred and No/100 Dollars ($1,500.00), and Sexton shall perform no act in said capacity without Gatlin's approval; and M. W. Markham shall perform

the duties of General Manager of AHB, effective on the execution hereof."

Paragraph X provides:

"Sexton, Hall and Smith agree that the books and accounts of the corporations herein named (except Texas Capital) are presently available for examination and that Investors, its agents, servants, and employees, shall have full access to all of the records of said corporations for purpose of verifying all the assets as above warranted and represented."

On November 2, 1965, the defendants Sexton, Hall and Smith, as assignors, and Investors Thrift, as assignee, executed an "Assignment of Stock Powers." The document witnesses that the assignee had entered into an agreement with assignors to acquire all of the stock which assignors may own or hold in PL&I and/or AHB or any of their subsidiary corporations; that assignors' stock is held in pledge by Texas Capital Corporation; that assignee had agreed to pay to said corporation the sum of $400,000.00 concurrently with the execution of this agreement, and the further and additional sum of $150,000.00 on January 1, 1966, and a further additional sum of $115,583.27 on June 30, 1966, plus accumulated interest, and:

"WHEREAS, the parties mutually desire to provide for the control, custody and voting privileges attendant to the aforementioned stock and have agreed upon the procedure for accomplishing such purpose.

"NOW, THEREFORE, it is by the parties agreed as follows:

"Assignors hereby sell, assign, set over and convey to Assignee, their right, title and interest in and to any and all stock standing in the name of Assignors, or either of them, on the corporate books of Peoples

Loan & Investment Company or American Home Builders, Inc., together with the right to vote such stock for all corporate purposes.

"This Assignment is expressly conditioned upon Assignee's making of timely payments of the sums set forth above to Texas Capital Corporation, and in the event Assignee should fail or refuse to make the payments at the time and in the manner set forth above, then this assignment shall be and become void and of no further force and effect."

The plaintiffs had full access to all of the records of the corporations from the date of the option, September 9, 1965, for the purpose of verifying all statements made relative to the assets by Sexton, Hall and Smith. All the payments agreed upon in the option and in the Assignment of Stock Powers were paid on or before January 10, 1966, and complete control of all the corporate entities mentioned in the option and Assignment of Stock Powers was delivered to Investors on or before January 10, 1966.

The above facts are not controverted. In the supplemental brief of plaintiffs submitted January 10, 1969, the plaintiffs attached the affidavits of Ilo Vanderboom, Andy DeHaan, James Nachtigal, H. T. Ringling and Robert Carter, but such affidavits do not deal with the question before the court, but only deal with the issues that would probably be material in a trial on the merits.

The material and relevant facts uncontrovertibly establish that the suit was commenced by the filing of the complaint on July 18, 1968, and the question that the court must determine from these facts is whether the claim or claims as alleged by plaintiffs were barred by the applicable statute of limitations at the time of the filing of the suit.

Plaintiffs' federal cause of action is based on § 10(b) of the Securities Exchange Act of 1934; 15 U. S. C. A.,

§ 78j(b)[1], § 17(a) of the Securities Act of 1933, 15 U. S. C. A., § 77(q)[2], and Rule 10b-5 of the Rules and Regulations of the Securities and Exchange Commission (17 C. F. R. 240.10b-5[3]). A violation of § 10(b) and Rule 10b-5

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[1] 15 U. S. C. A., § 78j(b) is as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * * * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary of appropriate in the public interest or for the protection of investors."

[2] 15 U. S. C. A., § 77q provides:

"(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

[3] 17 C. F. R., § 240.10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud.

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the

will also result in a violation of § 17a of the Securities Act of 1933, 15 U. S. C. A., § 77q, where the alleged fraud occurs in the sale of the security. The provisions of the two sections are substantially the same, except that § 17a is limited to sales. In each case, the violation consists of a sale of a security **and** the use of any means or instrumentality of interstate commerce or the mails, **in connection** with the use of any device, scheme or artifice to defraud. Each element must bear a significant relationship to the others.

Both 15 U. S. C. A., § 77q and 15 U. S. C. A., § 78j(b) are silent as to limitation of actions, and it is, therefore, clear that the appropriate Arkansas limitations statute applies. Cope v. Anderson (1947), 331 U. S. 461, 67 S. Ct. 1340, 91 L. Ed. 1602; Holmberg v. Armbrecht (1946), 327 U. S. 392, 66 S. Ct. 582, 90 L. Ed. 743; Myzel v. Fields (8 Cir. 1967), 386 F. 2d 718, cert. den. 390 U. S. 951 (1968); Charney v. Thomas (6 Cir. 1967), 372 F. 2d 97; Janigan v. Taylor (1 Cir. 1965), 344 F. 2d 781, cert. den. 382 U. S. 879 (1965); Hooper v. Mountain States Securities Corp. (5 Cir. 1960), 282 F. 2d 195, cert. den. 365 U. S. 814, 81 S. Ct. 695, 5 L. Ed. 2d 693; Errion v. Connell (9 Cir. 1956), 236 F. 2d 447; Fratt v. Robinson (9 Cir. 1953), 203 F. 2d 627; Fischman v. Raytheon Mfg. Co. (2 Cir. 1951), 188 F. 2d 783; Maher v. J. R. Williston & Beane, Inc. (S. D. N. Y. 1967), 280 F. Supp. 133; Trussell v. United Underwriters, Ltd. (D. C. Col. 1964), 228 F. Supp. 757; Connelly v. Balkwill (N. D. Ohio 1959), 174 F. Supp. 49; Tobacco and Allied Stocks v. Transamerica Corp. (D. C. Del. 1956), 143 F. Supp. 323; Northern Trust Co. v. Essaness Theatres

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circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Corp. (N. D. Ill. 1952), 103 F. Supp. 954; Osborne v. Mallory (S. D. N. Y. 1949), 86 F. Supp. 869.

Section 22 of the Arkansas Securities Act of 1959 (Ark. Stat. Ann., § 67-1256(c) (Repl. 1966)), which is § 410 (c) of the Uniform Securities Act, provides in part:

"No person may sue under this section more than two years after the contract of sale."

See Central Investments v. Polk (1965), 239 Ark. 165, 388 S. W. 2d 381.

The general statute of limitations apparently applicable to actions based on common-law fraud and deceit is Ark. Stat. Ann., § 37-206 (Repl. 1962),[1] which provides that certain actions must be brought within three years after the accrual of the cause of action. As hereinbefore stated, the court, sua sponte, on December 5, 1968, dismissed the claim of plaintiffs based on the common law for lack of jurisdiction, but both statutes of limitations will be considered and discussed since plaintiffs contend that the

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[1] **"37-206. Actions which must be brought in three years—Contracts not in writing—Rent—Trespass—Libel—Injury to goods.—**

"The following actions shall be commenced within three (3) years after the passage of this act, or, when the cause of action shall not have accrued at the taking effect of this act, within three (3) years after the cause of action shall accrue: First, all actions (of debt) founded upon any contact, obligation, or liability, (not under seal [and not in writing],) excepting such as are brought upon the judgment or decree of some court of record of the United States, of this, or some other state; (second, all actions upon judgments rendered in any court not being a court of record;) third, all actions for arrearages of rent (not reserved by some instrument in writing, under seal); fourth, all actions (of account, assumpsit, or on the case,) founded on any contract or liability, expressed or implied; fifth, all actions for trespass on lands, or for libels; sixth, all actions for taking or injuring any goods or chattels."—

See, Air Leases, Inc. v. Baker (W. D. Ark. 1958), 167 F. Supp. 145; Burton v. Tribble (1934), 189 Ark. 58, 70 S. W. 2d 503; Field v. Gazette Publishing Company (1933), 187 Ark. 253, 59 S. W. 2d 19; Dilley v. Simmons National Bank (1913), 108 Ark. 342, 158 S. W. 144.

general statute should be applied. The question thus arises as to which statute of limitations the court must apply. The court must choose the one which best effectuates the federal policy at issue. Charney v. Thomas, supra. The plaintiffs on their brief cite Charney and cases cited therein for the proposition that, as between the general statute of limitations and the one contained in the Arkansas Securities Act, the former should apply. First, it must be kept in mind that the court is not here faced with a choice between a catch-all statute of limitations on actions to recover on a liability created by statute and a statute of limitations which by its provisions is specifically applicable to fraud. Errion v. Connell (9 Cir. 1956), 236 F. 2d 447; Fratt v. Robinson (9 Cir. 1953), 203 F. 2d 627; Fischman v. Raytheon Mfg. Co. (2 Cir. 1951), 188 F. 2d 783; Connelly v. Balkwill (N. D. Ohio 1959), 174 F. Supp. 49. In the instant case, Arkansas has no statute of limitations which specifically includes fraud. Ark. Stat. Ann., § 37-206 (Repl. 1962), is in fact a catch-all statute which was made to include fraud by judicial decision: Air Leases v. Baker (W. D. Ark. 1958), 167 F. Supp. 145, citing cases. Nor does the court agree that the choice confronting it is one between a general statute of limitations applicable to fraud and a statute of limitations in a state "blue sky" law containing no provisions similar to § 10b of the Securities Exchange Act of 1934. The court in Charney, at page 100 of 372 F. 2d, stated:

> "Although in some cases the Local Blue Sky Law might be the more appropriate point of reference, in the present case the Michigan law contains no provision similar to section 10b of the federal law. Thus, the normal six-year period of M. S. A., § 27A.5813, should apply despite the fact that actions under section 10b are not exactly the same as common law fraud actions."

The Michigan law to which the court referred was the Michigan "Blue Sky Law", M. S. A., § 19.756, Comp. Laws 1948, § 474.116, which borrows almost verbatim § 12(2) of the Securities Act of 1933, 15 U. S. C. A., § 71(2).

In Trussell, supra, the question of the applicability of the statute of limitations contained in the state "blue sky" law was reached somewhat circuitously. There the choice was between a three-year statute of limitations specifically applicable to fraud, a three-year residuary statute applicable to other actions for which no period of limitations was provided, and a two-year statute of limitations applicable to actions on a liability created by federal statute where the statute involved contained no period of limitations. The plaintiffs contended that the two-year statute amounted to an unconstitutional discrimination against federal causes of action. The defendants argued that there would be no unconstitutional discrimination as the Colorado Securities Act (which is identical to the Arkansas Securities Act) also contained a two-year limitations statute. The court, at page 776 of 228 F. Supp., stated:

> "We regard that statute of limitations as one which is necessarily restricted in its applicability to violations of that Act, however, Civil actions arising under the Colorado Securities Act (to the extent relevant here in comparison with a § 10(b) action) are strictly analogous to a § 12(2) action—but not to * * * a § 10(b) action * * *."

Section 12(2) of the Securities Act of 1933 is substantially identical to § 410(a)(2) of the Uniform Securities Act, which has been adopted in Michigan,[5] Colo-

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[5]At the time **Charney** was commenced, Michigan had not adopted the Uniform Securities Act. Michigan adopted the Act in 1964, and it became effective on January 1, 1965. The plaintiffs filed suit in February 1964, but as indicated above prior Michigan law regarding civil liability was identical to § 12(2).

rado, and Arkansas, Ark. Stat. Ann., §§ 67-1235—67-1262 (Repl. 1966), as well as in many other states. Section 410 is the only section of the Uniform Act which provides a private remedy. Rule 10b-5 is codified as § 101 of the Uniform Act, Ark. Stat. Ann., § 67-1235 (Repl. 1966),[6] but it was the intent of the drafters that no private remedy would be available under **state** law other than as set forth in § 410, Ark. Stat. Ann., § 67-1256 (Repl. 1966).[7]

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[6] "67-1235. **Unlawful acts in connection with offer, sale or purchase of securities.—**

"It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

[7] The Commissioners' Note to § 101 of the Uniform Act, Ark. Stat. Ann., § 67-1235 (Repl. 1966), states in part:

"The sanctions for the conduct which is made 'unlawful' by § 101 (or any other section which makes conduct 'unlawful') are found in Parts II, III and IV of the statute. Those sanctions include administrative proceedings of various sorts under §§ 204 and 306 when a registration of a broker-dealer, agent, investment adviser, or security is pending or effective under Part II or III; judicial injunction under § 408; and criminal prosecution under § 409. Section 410(h) provides that 'unlawful' conduct does not result in civil liability except as provided in § 410."

Section 410(h) of the Uniform Act, Ark. Stat. Ann., § 67-1256(h) states:

"The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified **in this section** or section 202(c)."

The Commissioners' Note to § 410 (h) of the Uniform Act states in part:

"Notwithstanding the presence of several specific liability provisions in each of the several SEC statutes, the federal

The courts in Charney and in Trussell held, without discussion, that an action under a provision of state securities law similar to § 12(2) is not analogous to an action under Rule 10b-5, at least for the purpose of applying the statute of limitations contained in the state securities act. The decision in Trussell is distinguishable from the instant case, as the District Court for the District of Colorado is bound by a decision that the plaintiff must allege and prove scienter on the part of the seller as an element of the violation. Rice v. United States (10 Cir. 1945), 149 F. 2d 601. Where proof of scienter is required, the requisites of proof in an action based on Rule 10b-5 are substantially similar to an action based on common-law fraud, providing some basis for application of the statute of limitations applicable to the latter. In Myzel v. Fields, supra, the Court of Appeals for the Eighth Circuit held that proof of scienter is **not** required in an action based on Rule 10b-5. In addition, and this is the point on which the court differs with Charney, clause (2) of Rule 10b-5 is clearly embodied in § 12(2) of the Securities Act of 1933 and in § 410(a)(2) of the Uniform Securities Act, Ark. Stat. Ann., § 67-1256(a)(2) (Repl. 1966), the corresponding provision in Arkansas, states in part:

> "(a) Any person who . . .
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> * * * * * * *
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> "(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of circumstances under which they are made, not

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courts have implied a civil cause of action by a defrauded seller against the buyer under SEC Rule X-10B-5. * * * The 'but' clause in § 410(h) is designed to assure that no comparable development is based on violation of § 101 of this Act."

misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him * * *."

Moreover, it is clear that from its inception § 10b has been acknowledged as a catch-all provision. Securities and Exchange Comm. v. Texas Gulf Sulphur Co. (2 Cir. 1968), 401 F. 2d 833. In Bromberg, Securities Law: Fraud —SEC Rule 10b-5, § 2.4 (1968), the learned author, in discussing overlaps among the SEC fraud provisions, states:

> "Far more serious is the role of implication in administering the several provisions. Because of their similarities, something left out of one but included in another suggests strongly that it was omitted deliberately from the first and not intended to be read in. This is the doctrine of *expressio unius est exclusio alterius*, which has a respectable history and logic, reinforced by reference to the inclusion in a parallel provision. **The history of 10b-5 is a massive rejection of this approach.**"

Thus, the clear implication of Rule 10b-5 is that it was intentionally drawn broadly in terms of persons and transactions and that, due to its breadth, it is not inconsistent with the other SEC provisions relating to fraud. In fact, each of the major SEC fraud provisions contains the equivalent of clause (2) of Rule 10b-5.

In Thiele v. Shields (S. D. N. Y. 1955), 131 F. Supp. 416, an action based on misrepresentation in the sale of municipal bonds, the defendants urged that relief under Rule 10b-5 and § 17(a) of the 1933 Act be denied as inconsistent with the municipal bond exception contained

in § 12(2). In disposing of the defendants' contention, the court at page 419 stated:

> "However, the moving defendants urge, in substance, that to the extent that the Section 12(2) municipal bond exemption from civil liability arising from misrepresentations in a prospectus or oral communication is inconsistent with Sections 17(a) and 10(b), civil remedies under the latter sections should be denied. Although this proposition may be maintainable in the abstract, there is no inconsistency between Section 12(2), on the one hand, and Sections 17(a) and 10(b), on the other hand, when those sections are read *in pari materia* and are applied to the particular allegations here presented."

The reasoning of the New York District Court is clearly applicable to the instant case, as the plaintiffs' allegations, if proven, would amount to a violation of both § 12(2) and Rule 10b-5. The primary difference between § 12(2) and Rule 10b-5 regarding fraud in the sale of securities is that § 12(2) gives a defense that the defendant did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. There are no express defenses to an action under Rule 10b-5, and a short period of limitations is, therefore, appropriate.

It is no doubt true, as plaintiffs suggest, that a cause of action under Rule 10b-5 existed prior to and at the time of adoption of the Uniform Securities Act in Arkansas. Since 1959, however, federal courts sitting in Arkansas have had a choice in Rule 10b-5 cases between applying the general statute of limitations and that contained in the Arkansas Securities Act, although the issue has not been raised in a reported case. The choice of the court in this action in no way affects actions brought under state law, based either on common-law fraud and deceit or on Ark. Stat. Ann., § 67-1256 (Repl. 1966). The fact that, under

Arkansas law, a defrauded purchaser has a choice of civil remedies under the Arkansas Securities Act or at common-law, whereas the defrauded seller has only the latter, is a matter for the legislature to correct if it should so desire. However, such a change appears unlikely in view of the Commissioners' Notes to the Uniform Act, footnote 7, supra.

It should also be kept in mind that the defrauded purchaser proceeding under Arkansas law is not completely free to pick and choose as he will. His choice on one hand is an action at common law, with its greater burden of proof and longer period of limitations. On the other, he may proceed under Ark. Stat. Ann., § 67-1256 (Repl. 1966), which, although the burden of proof is less, is tempered by a shorter statute of limitations. An action under Rule 10b-5, however, is available to both defrauded purchasers and sellers, and the same period of limitations will apply to any action brought by either. This would obviously be the case no matter which period of limitations the court chose.

It is also true that, in an action based on Rule 10b-5, the plaintiffs are required to make an election between rescission and a suit for damages, at least where the pursuit of inconsistent forms of relief becomes prejudicial to the defendants, Myzel v. Fields, supra, pp. 740-741. On the other hand, if the decisions interpreting § 12 of the Securities Act of 1933, 15 U. S. C. A., § 771, are followed in state actions based on Ark. Stat. Ann., § 67-1256 (Repl. 1966), the defrauded purchaser will be limited to rescission if he chooses to retain the stock. Deckert v. Independence Corp. (1940), 311 U. S. 282, 288, 61 S. Ct. 229, 85 L. Ed. 189. However, this procedural difference does not supply a reason for choosing the longer period of limitations in actions based on Rule 10b-5.

The plaintiffs also contend that the defendant Texas Capital Corporation can be held liable as an aider and

abettor of the principal sellers under § 20 of the Securities Exchange Act of 1934, 15 U. S. C. A., § 78t, and that Texas Capital is beyond the reach of Ark. Stat. Ann., § 67-1256(b) (Repl. 1966). It is, of course, unnecessary for the court to decide whether Texas Capital can be held liable either under the Arkansas statute or federal law. In any event, the determination of that question would bear little weight as to whether an action under Rule 10b-5 is sufficiently analogous to an action under the Arkansas Securities Act to apply the period of limitations of the latter.

Finally the court must select, as heretofore stated, the period of limitations that best effectuates the federal policy at issue. It is today unquestioned that a civil remedy based on Rule 10b-5 exists in favor of both buyers and sellers, and that the applicable statute of limitations is that of the forum. In selecting the proper statute of limitations, the obvious choice is the state statute of limitations directed toward securities fraud, if one exists. In addition, this court is bound by the decision in Myzel v. Fields, supra, that no allegation of scienter is required in an action under Rule 10b-5. That decision results in an irreconcilable difference between an action based on 10b-5 and an action based on common-law fraud and deceit.

Plaintiffs, contending otherwise, argue that Fausett & Co. v. Bullard (1950), 217 Ark. 176, 229 S. W. 2d 490, stands for the proposition that an honest misrepresentation of a material fact relied upon by a purchaser in Arkansas, is grounds for a common-law fraud action, regardless of whether the person making the representation did not know the truth and in the exercise of reasonable care could not have known of the truth. Dean Prosser, on the other hand, lists Arkansas among those jurisdic-

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[8] Prosser on Torts, § 102 (3d Ed. 1964).

tions which purport to follow the rule of Derry v. Peek (1889), 14 A. C. 337, 58 L. J. Ch. 864, which excludes from actual fraud any misrepresentation which is innocent, or merely negligent, citing Sledge & Norfleet Co. v. Mann (1937), 193 Ark. 884, 103 S. W. 2d 620. The court therein stated, at 193 Ark. 888-889:

> "The law of the subject is well settled. In First National Bank of Newark v. People's National Bank of Springfield, 97 Ark. 15, 132 S. W. 1008, the late Chief Justice Hart quoted with approval from Hanger v. Evins, 38 Ark. 334, the following: 'A false representation, to be actionable, must not only mislead, but must be made fraudulently, and with that intent. No one can be held liable for a false representation who honestly believed it when made, however false it may be; but he is liable if he knew it to be false, or, knowing nothing about it, asserted it to be true.' * * *
>
> "In Troyer v. Cameron, 160 Ark. 421, 254 S. W. 688, the court quoted the following as the rule of the court governing actionable misrepresentations: 'In order that representations may be fraudulent at law, they must be made by one who either knows them to be false, or else, not knowing, asserts them to be true, and made with the intent to have the other party act upon them to his injury, and such must be their effect.'"

The intent required in a common-law action for actual fraud and deceit is a belief that the representation is false, or an absence of belief that the representation is true. In short, representations are considered to be fraudulent if made by one who either knows them to be false or else, not knowing, asserts them to be true. Croley v. Baker (1963), 237 Ark. 136, 371 S. W. 2d 830; Maurice v. Chaffin (1951), 219 Ark. 273, 241 S. W. 2d 257; City National Bank v. Sternberg (1938), 195 Ark. 503, 114 S. W.

2d 39; National Life & Accident Ins. Co., Inc., v. Hitt (1937), 194 Ark. 691, 109 S. W. 2d 426; Laney-Payne Farm Loan Co. v. Greenshaw (1928), 177 Ark. 589, 9 S. W. 2d 19. The court does not construe Fausett to be a departure from that principle. The necessary intent to deceive was therein found in representations made by one conscious that he had no sufficient basis of information to justify them. Prosser, supra, footnote 8. Arkansas has not yet opened the action of deceit to innocent misrepresentations, although a small number of cases apparently rely on "constructive" fraud, primarily as a matter of public policy. Lane v. Rachel (1965), 239 Ark. 400, 389 S. W. 2d 621; Arkansas Valley Compress & Warehouse Co. v. Morgan (1950), 217 Ark. 161, 229 S. W. 2d 133; Kersh Lake Drainage District v. Johnson (1941), 203 Ark. 315, 157 S. W. 2d 39; Stewart v. Clark (1938), 195 Ark. 943, 115 S. W. 2d 887; Levinson v. Treadway (1935), 190 Ark. 201, 78 S. W. 2d 59. In Arkansas State Highway Comm. v. Clemmons (1958), 224 Ark. 1124, ... S. W. 2d ..., the doctrine is recognized but not applied.

In addition, a common-law action for fraud and deceit embraces the concept of justifiable reliance, Prosser on Torts, § 103 (3d Ed. 1964), whereby the person defrauded bears the burden of showing by substantial evidence that he relied and acted upon the false representation to his damage. Republic Mining & Mfg. Co. v. Ebrod (1945), 208 Ark. 150, 185 S. W. 2d 99. In contrast, the reliance required under Rule 10b-5 is, at best, minimal. In Myzel v. Fields, at page 735 of 386 F. 2d, the court stated:

> "Professor Loss points out that in cases of nondisclosure, if reliance is a prerequisite of a Rule 10b-5 action, it is 'little more than a formal requirement.' 3 Loss 1765. However the Court of Appeals for the Second Circuit in List v. Fashion Park, Inc., supra,

340 F. 2d at 463, best states the rule that should govern this phase of a Rule 10b-5 suit:

> "'On the other hand, we do not agree with certain overtones in the opinion of the trial court concerning the meaning of "reliance" in a case of non-disclosure under Rule 10b-5. The opinion intimates that the plaintiff must prove he actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. Such a requirement, however, would unduly dilute the obligation of insiders to inform outsiders of all material facts, regardless of the sophistication or naivette of the persons with whom they are dealing. * * *
>
> "'The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact. Speed v. Transamerica Corp., 99 F. Supp. 808, 829; Kardon v. National Gypsum Co., 73 F. Supp. 798, 800 (E. D. Pa. 1947). To put the matter conversely, insiders "are not required to search out details that presumably would not influence the person's judgment with whom they are dealing." Kohler v. Kohler Co., supra, 319 F. 2d at 642. This test preserves the common law parallel between "reliance" and "materiality," differing as it does from the definition of "materiality" under Rule 10b-5 solely by substituting the individual plaintiff for the reasonable man.'"

The burden of proof on plaintiff in a Rule 10b-5 action is slight, and there are no express defenses available to

defendant. The period of limitations should be correspondingly short. The court is of the opinion that in view of the uncontroverted facts, the two-year statute of limitations in Ark. Stat. Ann., § 67-1256(e) should be applied and the plea of the statute of limitations sustained.

Therefore, summary judgment is being entered today dismissing the complaint of plaintiffs asserting a cause of action under the federal statutes against the defendants and adjudging costs against the plaintiffs.

This 24th day of January, 1969.

APPENDIX "D"

In the United States District Court
Western District of Arkansas
Fort Smith Division

(Caption Omitted)

Order

On this day upon consideration of the motions for summary judgment filed herein, on December 16, 1968 by defendant Sam Sexton, Jr.; on December 20, 1968 by defendants Austin Gatlin, Erma S. Gatlin, Diamond G Ranch, Inc., and TeleCom Corporation; and on December 23, 1968 by James S. Hall, the court has prepared and filed its opinion, and in accordance therewith.

It Is Ordered and Adjudged that said motions be and they are granted and the complaint of plaintiffs asserting a cause of action under the federal statutes against the defendants is dismissed, and defendants shall recover from plaintiffs their costs herein expended.

This January 24, 1969.

APPENDIX "E"

No. 19,682-19,684

United States Court of Appeals
for the Eighth Circuit

(Caption Omitted)

Decided March 20, 1970

Before: Mehaffy, Gibson and Heaney, Circuit Judges

Petition of appellants for re-hearing filed in the above cases, having been considered, it is now here ordered by this Court that the same be, and it is hereby, denied.